SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1964

No. 63

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

CLAY B. BROWN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Nos. 18228—18233

United States Court of Appeals

for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CLAY B. BROWN and DOROTHY E. BROWN, DONALD L. BROWN and INGRID R. BROWN, CHARLES WILLIAM BOOTH and NANCY H. BOOTH, DONALD LEE BROWN, PHILIP F. BROWN, MARILYN BROWN,
Respondents.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

NAMES AND ADDRESSES OF ATTORNEYS

LOUIS J. OBERDORFER,
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Washington 25, D. C.

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WILLIAM H. KINSEY,
Board of Trade Building,
Portland 4, Oregon.

Attorneys for Respondents.

The Tax Court of the United States

Docket No. 83795

CLAY B. BROWN and DOROTHY E. BROWN,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioners hereby petition for redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Ap:P:AA:HH-90D:MAC) dated July 30, 1959, and as a basis for their petition allege as follows:

1. The petitioners are husband and wife residing in Portland, Oregon. During the periods herein involved petitioners filed joint income tax returns with the District Director of Internal Revenue for the District of Oregon.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioners on July 30, 1959.

3. The deficiencies as determined by the Commissioner are for income taxes for the below indicated calendar years in the below specified amounts:

Taxable Year Ended	Deficiency
December 31, 1953	$ 2,732.62
December 31, 1954	5,073.80
December 31, 1955	50,779.14
Total	$58,585.56

Substantially all of the above deficiencies are in dispute.

4. The determination of income tax set forth in said notice of deficiency is based upon the erroneous determination that the gain reported by petitioners from the sale of their stock in Clay Brown & Company, an Oregon corporation, constituted ordinary income rather than long term capital gain.

5. The facts upon which the petitioners rely as the basis of this case are as follows:

(a) On September 30, 1946 petitioners each acquired 6000 shares of the common stock of Clay Brown & Company at a cost of $1.00 per share, making a total of 12,000 shares having an aggregate cost of $12,000.00.

(b) Petitioners held said 12,000 shares of stock from the date of acquisition until February 1953.

(c) Said shares of stock were not held by petitioners for sale to customers in the ordinary course of business, or in any other manner which would preclude such shares from qualifying as a capital asset.

(d) In February 1953, petitioners sold said 12,000 shares to California Institute for Cancer Research under a written purchase agreement dated February 4, 1953 for the sum of $440,625.00 payable as provided in the purchase agreement.

(e) The gain realizable by petitioners upon such sale of the 12,000 shares was $414,000.00, being the $440,625.00 purchase price less the cost basis

of $12,000.00 and less expenses of sale in the amount of $14,625.00.

(f) In their income tax returns for the subject years petitioners reported on the installment basis the following amounts as long term capital gain:

Year	Gain
1953	$ 4,121.87
1954	16,688.28
1955	111,511.28

Such amounts are portions of the purchase price received during the indicated years reportable on the installment basis.

(g) The 12,000 shares of stock in Clay Brown & Company were capital assets held by petitioners for more than six months, and the gain identified in subparagraph (f) above constituted proceeds from the sale of such capital assets entitled to long term capital gain treatment.

Wherefore, the petitioners pray that this Court may hear the proceeding and determine that the deficiencies due from petitioners for the years 1953, 1954 and 1955 do not exceed the comparatively small amounts resulting from the proposed adjustments other than the adjustment asserted as erroneous in this petition.

/s/ WILLIAM H. KINSEY,
Tenth Floor Board of Trade Building,
Portland 4, Oregon

[Duly Verified]

Exhibit A

Letterhead of
U. S. Treasury Department
Internal Revenue Service
Office of Regional Commissioner

Registered Mail

July 30, 1959

Ap:P:AA:HH-90D:MAC
425 Pittock Block
921 S. W. Washington Street
Portland 5, Oregon

Taxable Year Ended	Deficiency
December 31, 1953	$ 2,732.62
December 31, 1954	5,073.80
Total	$58,585.56
December 31, 1955	50,779.14

Mr. Clay B. Brown
Mrs. Dorothy E. Brown
1000 S.W. Vista Avenue
Portland, Oregon

Dear Mr. and Mrs. Brown:

The determination of your income tax liability for the above taxable year(s) discloses a deficiency or deficiencies in the amount(s) shown above and in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court

of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency or deficiencies. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you desire to file a petition, you are requested to execute the enclosed agreement form (Form 870) and forward it to the above address. Please cite the reference shown at the top right of this letter. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earliest.

Very truly yours,
Dana Latham
Commissioner
By (Signed) A. N. WILLIAMS
Associate Chief,
Appellate Division
Division

Enclosures:
Statement
Pub. #160
Agreement form (Form 870)
MACascaden 1a

Statement

Taxpayers: Clay B. and Doroty E. Brown
1000 S. W. Vista Avenue
Portland, Oregon
(formerly: 01962 S. W. Military Road)

Income tax liability for the taxable years ended December 31, 1953, December 31, 1954 and December 31, 1955.

Year	Tax Deficiency
1953	$ 2,732.62
1954	5,073.80
1955	50,779.14
	$58,585.56

In making this determination of your tax liability careful consideration has been given to the report of examination transmitted to you December 17, 1957, to your protest received February 6, 1958, and September 9, 1958, March 30, 1959 and April 17, 1959.

A copy of this letter and statement has been mailed to your representative, Mr. William H. Kinsey, Board of Trade Building, Portland 4, Oregon, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended December 31, 1953

Adjustments to Net Income

Net income disclosed by return		$50,880.12
Unallowable deduction and additional income		
(a) Other compensation	$ 691.90	
(b) Dividends	562.81	
(c) Partnership income—auto depreciation	307.09	
(d) Other income	4,116.28	
Total	5,678.08	
Nontaxable income and additional deductions:		
(e) Capital gain	2,060.94	
Total adjustment increase		3,617.14
Net income as adjusted		$64,497.26

Taxable Year Ended December 31, 1953

Explanation of Adjustments

(a) During the year 1953 the corporation Fortuna Sawmills, Inc., of which Clay Brown was the general manager, paid certain social club dues and expenses for his personal benefit, as follows:

Arlington Club dues	$243.00
Waverly Club dues and expenses	448.90
Total	$691.90

It is held that said expenditures constitute additional compensation to be treated as ordinary income to Clay Brown. Accordingly, ordinary net income has been increased by the amount of $691.90.

(b) During the year 1953 the corporation Clay Brown & Company paid legal fees and appraisal fees in the respective amounts of $1,250.00 and $250.82, or $1,500.82 in all, solely for the benefit of the stockholders.

It is held that said expenditures represented the distribution of taxable dividend income, constructively received in the hands of the stockholders. You owned 12,000 shares of stock out of 32,000 shares outstanding. Your proportionate share is, therefore, 12/32nds of $1,500.82 or $562.81. Accordingly, ordinary net income has been increased by the amount of $562.81.

(c) Adjustment is made for depreciation on your personal automobiles which was claimed as an item of expense on the partnership return of Brown Timber & Investment Co. Computation is as follows:

*Buick 1953 4-dr Sedan 2/13/53 (4 yrs.) $3,104.24 =	$258.68
*Chevrolet 1953 2-dr Sedan 4/20/53 (4 yrs.) $2,323.65 =	48.41
*Part of year	$307.09

(d) and (e) On your return as filed you reported long term capital gain as from the sale of all of your stock in Clay Brown & Company, on the installment plan, in the amount of $4,121.87, of which one-half, or $2,060.94 was taken into account.

It is held that the transactions involved gave rise to ordinary income under Section 22(a) of the Internal Revenue Code of 1939, and that the taxable income therefrom for the year 1953 is in the amount of $4,116.28. (See Schedule I attached hereto for explanation of the difference between $4,121.87 and $4,116.28).

Accordingly, ordinary net income has been increased by the amount of $4,116.28, and long term capital gain taken into account as reported has been decreased by the amount of $2,060.94.

Computation of Tax — 1953
(Alternative Method)

Net income as adjusted	$64,497.26
Less: Exemptions 2x$600	1,200.00
Taxable income	63,297.26
Enter one-half—joint return	31,648.63
Less: 50% of net long term capital gain—if joint return, enter one-half	1,270.27
Balance subject to normal tax and surtax	$30,378.38
Partial tax	14,929.51
Times two—joint return	29,859.02
Add: Net long term capital gain—104% of amount shown above	1,321.06
Tax liability	$31,180.08
Self employment tax—Dorothy E. Brown	81.00
Total tax liability	31,261.08
Liability disclosed by return, Account No. AF 1000565	28,528.46
Deficiency	$2,732.62

Taxable Year Ended December 31, 1954
Adjustments to Net Income

Net income disclosed by return		$42,529.62
Unallowable deduction and additional income		
(a) Other compensation	$ 270.75	
(b) Other income	16,664.21	
Total	16,934.96	
Nontaxable income and additional deductions:		
(c) Capital gains	8,344.14	
Total adjustment increase		8,590.82
Net income as adjusted		$51,120.44

Taxable Year Ended December 31, 1954
Explanation of Adjustments

(a) During the year 1954 the corporation Fortuna Sawmills, Inc., of which Clay Brown was the general manager, paid certain social club dues and expenses for his personal benefit, as follows:

Arlington Club dues	$114.00
Waverley Club dues and expenses	156.75
Total	$270.75

It is held that said expenditures constitute additional compensation to be treated as ordinary income to Clay Brown. Accordingly, ordinary net income has been increased by the amount of $270.75.

(b) and (c) On your return as filed you reported long term capital gain as from the sale of all of your stock in Clay Brown & Company, on the installment plan, in the amount of $16,688.28, of which one-half, or $8,344.14 was taken into account.

It is held that the transactions involved gave rise to ordinary income under Section 61 (a) of the Internal Revenue Code of 1954, and that the taxable income therefrom for the year 1954 is in the amount of $16,664.21. (See Schedule I attached hereto for explanation of the difference between $16,688.28 and $16,664.21).

Accordingly, ordinary net income has been increased by the amount of $16,664.21, and long term capital gain taken into account as reported has been decreased by the amount of $8,344.14.

Computation of Tax—1954

Net income as adjusted	$51,120.44
Less: Exemptions 4 x $600	2,400.00
Taxable income	48,720.44
Enter one-half—joint return	$24,360.22
Tax	9,772.53
Tax liability—times two—joint return	19,545.06
Liability disclosed by return, Account No. BC783	14,471.26
Deficiency	$5,073.80

Taxable Year Ended December 31, 1955

Adjustments to Net Income

Net income disclosed by return	$ 96,943.50
Unallowable deduction and additional income (a) Other income	111,359.85
Total	$208,303.35
Nontaxable income and additional deductions:	
(b) Capital gains	55,755.64
Net income as adjusted	$152,547.71

Explanation of Adjustments

(a) and (b) On your return as filed you reported long term capital gain as from the sale of all of your stock in Clay Brown & Company, on the installment plan, in the amount of $111,511.28, of which one-half, or $55,755.64 was taken into account.

It is held that the transactions involved gave rise to ordinary income under Section 61(a) of the Internal Revenue Code of 1954, and that the taxable income therefrom for the year 1955 is in the amount of $111,359.85. (See Schedule I attached hereto for explanation of the difference between $111,511.28 and $111,359.85)

Accordingly, ordinary net income has been increased by the amount of $111,359.85 and long term capital gain taken into account as reported has been decreased by the amount of $55,755.64.

Computation of Tax—1955

Net income as adjusted	$152,547.71
Less: Exemptions 4 x $600	2,400.00
Taxable income	$150,147.71
Tax liability	92,459.65
Liability disclosed by return, Account No. EF 2539	41,680.51
Deficiency	$ 50,779.14

SCHEDULE I

	Per Returns Filed		Corrected	
Total amount to be received		$440,625.00		$440,625.00
Less:				
Basis claimed	$ 12,000.00		$ 12,000.00	
Expense attributable to transaction	14,625.00		14,625.00	
Legal & appraisal expense	—		562.81	
		26,625.00		27,187.81
Total net gain		414,000.00		413,437.19
Percent of gain to total amount to be received		93.9574%		93.83%
Year 1953:				
Amount received in 1953	4,386.96		4,386.96	
Portion thereof representing gain, per above percentage factors		$ 4,121.87		$ 4,116.28
Year 1954:				
Amount received in 1954	18,893.08		18,893.08	
Portion thereof representing gain, per above percentage factors		17,751.45		17,727.38
Less Additional expenses attributable to transaction, paid in 1954		1,063.17		1,063.17
Net gain, year 1954		$ 16,688.28		$ 16,664.21
Year 1955:				
Amount received in 1955	118,862.14		118,862.14	
Portion thereof representing gain, per above percentage factors		111,679.78		111,528.35
Less additional expenses attributable to transaction, paid in 1955		168.50		168.50
Net gain, year 1955		$111,511.28		$111,359.85

[Representative of all Petitions.]

Received and Filed Oct. 26, 1959.

Served Oct. 26, 1959.

[Title of Tax Court and Cause.]

ANSWER

The Respondent, in answer to the petition filed in the above-entitled case, admits and denies as follows:

1. Admits the allegations in paragraph 1 of the petition.

2. Admits the allegations in paragraph 2 of the petition.

3. Admits the allegations in paragraph 3 of the petition.

4. Denies the allegations of error contained in paragraph 4 of the petition.

5. Denies the allegations contained in paragraph 5 of the petition and all subparagraphs thereof.

6. Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the deficiencies determined by the respondent be in all respects approved.

/s/ HART H. SPIEGEL,
Chief Counsel,
Internal Revenue Service.

Of Counsel:
CHARLES W. NYQUIST,
Acting Regional Counsel,
LEO K. O'BRIEN,
Attorney,
Internal Revenue Service,
484 Pittock Block,
Portland 5, Oregon

[Representative of all Answers.]

Received and Filed Dec. 18, 1959.
Served Dec. 22, 1959.

37 T. C. No. 50

Tax Court of the United States

Docket Nos. 83795, 83796, 83797, 83798, 83799, 83800.
Filed December 19, 1961.

CLAY B. BROWN and DOROTHY E. BROWN,[1]
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FINDINGS, CONCLUSIONS AND OPINION OF TAX COURT

Petitioners transferred their stock in a corporate enterprise, along with two primissory notes totaling $125,000, to I, a tax-exempt organization, in consideration for a non-interest-bearing note in the amount of $1,300,000. I was obligated to pay petitioners 90 percent of the income it received from a lease of the corporate assets in payment on the note but was not otherwise bound to make payment. I liquidated the corporation, sold its current assets subject to liabilities

---

[1]Proceedings of the following petitioners are consolidated herewith: Donald L. Brown and Ingrid R. Brown, Docket No. 83796; Charles William Booth and Nancy H. Booth, Docket No. 83797; Donald Lee Brown, Docket No. 83798; Philip F. Brown, Docket No. 83799; and Marilyn Brown, Docket No. 83800.

(other than the $125,000 of notes) and leased the fixed assets for a period of 5 years to a new corporation, F, which had been set up by a third party separate from petitioners. F was obligated to pay rent equal to 80 percent of its net profits before taxes and depreciation. At the termination of the 5-year lease the corporate assets were returned to I, which entered into an amended agreement with petitioners permitting it to negotiate a sale thereof even though the $1,300,000 note was not paid in full. The assets were subsequently sold by I to the State of California for $300,000, thus terminating the transaction between petitioners and I. Held, the transfer of petitioners' stock to I in return for the promissory note constituted the sale of a capital asset. Held, further, no part of the amounts received by petitioners is allocable to interest.

William H. Kinsey, Esq., and James R. Moore, Esq., for the petitioners.*

Norman H. McNeil, Esq., and Aaron S. Resnick, Esq., for the respondent.

Scott, Judge: Respondent determined deficiencies in petitioners' income taxes for the years and in the amounts as follows:

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*Brief amicus curiae was filed by Arthur A. Armstrong as attorney for the West Los Angeles Institute for Cancer Research.

Docket Number	Petitioner	Taxable Year	Deficiency
83795	Clay B. Brown and Dorothy E. Brown	1953	$ 2,732.62
		1954	5,073.80
		1955	50,779.14
83796	Donald L. Brown and Ingrid R. Brown	1954	2,080.04
		1955	16,621.28
		1956	5,815.76
83797	Charles William Booth and Nancy H. Booth	1953	79.74
		1954	231.66
		1955	2,005.41
		1956	840.97
83798	Donald Lee Brown	1953	1,445.28
83799	Philip F. Brown	1953	260.00
		1954	1,042.61
		1955	18,462.71
		1956	6,639.80
83800	Marilyn Brown	1953	260.00
		1954	1,003.39
		1955	18,465.66
		1956	6,590.81

The principal issue for decision is whether the gain realized by petitioners upon the disposition of their stock in Clay Brown & Company is long-term capital gain from the sale of such stock as reported by petitioners or ordinary income from a transaction which does not come within the provisions of section 117(a) of the Internal Revenue Code of 1939, and section 1222(3) of the Internal Revenue Code of 1954 as determined by respondent.

Respondent contends, in the alternative, that should it be decided that the disposition was a sale resulting in long-term capital gain, a part of the amounts received by petitioners in each of the years here involved was in payment of interest and taxable to petitioners as interest income under section 22(a) of the Internal Revenue Code of 1939 and section 61(a) of the Internal Revenue Code of 1954.

Findings of Fact.

Petitioners Clay B. Brown and Dorothy E. Brown are husband and wife residing in Portland, Oregon. They filed joint Federal income tax returns for the years, 1954, and 1955 with the district director of internal revenue for the district of Oregon.

Petitioners Donald L. Brown and Ingrid R. Brown are husband and wife now residing in Portland, Oregon. They filed joint Federal income tax returns for the years 1954, 1955, and 1956 with the district director of internal revenue at San Francisco, California. For the calendar year 1953 petitioner Donald L. Brown filed a separate Federal income tax return with the district director of internal revenue at San Francisco, California.

Petitioners Charles William Booth and Nancy H. Booth are husband and wife residing in Milwaukie, Oregon. They filed joint Federal income tax returns for the years 1953, 1954, 1955, and 1956 with the district director of internal revenue for the district of Orgeon.

Petitioner Philip F. Brown and petitioner Marilyn Brown, who reside in Portland, Oregon, each filed a separate income tax return for each of the years 1953, 1954, 1955, and 1956 with the district director of internal revenue for the district of Oregon.

Petitioner Clay B. Brown (hereinafter sometimes referred to as petitioner) has for many years been engaged in the lumber business as an executive of various lumber concerns. He is the father of Donald L., Philip F., and Marilyn Brown.

Clay Brown & Company (hereinafter sometimes referred to as the corporation) was incorporated under the laws of the State of Oregon on September 28, 1946, and until its dissolution on February 4, 1953, was qualified to do business in California. The corporation had authorized capital stock of 50,000 shares, par value $1 per share. Thirty-two thousand shares were issued and outstanding as follows:

Name	Date Acquired	No. of Shares	Cost	Official Title in Clay Brown & Co.
Clay B. Brown	9-30-46	6,000	$6,000.00	President
Dorothy E. Brown	9-30-46	6,000	6,000.00	None
Donald L. Brown	9-30-46	6,000	6,000.00	Ass't. Vice Pres.
Philip F. Brown	9-30-46	6,000	6,000.00	None
Marilyn Brown	9-30-46	6,000	6,000.00	None
Charles W. Booth	12-50	1,000	7,993.00	Secretary-Treasurer
Nancy H. Booth	4-52	500	4,000.00	None
C. A. Hill		500		Vice President

From the date of its incorporation through 1949, the corporation was engaged in the business of selling forest products at wholesale. In 1949 the corporation acquired millsite property at Fortuna, California and constructed thereon a gang mill and planning mill with substantially all new equipment. The gang mill and planning mill were put into operation during February 1950. In the spring of 1951 the corporation completed an additional unit consisting of a circular sawmill which was converted into a band sawmill during the fall of 1951. The gang mill, of a Swedish design, was the first of its type in California. The gang mill lent itself to the utilization of the small timber in the area, and permitted the conversion into merchantable lumber of timber previously ringed and permitted to die by ranchers in the clearing of grazing land. The output of the gang mill, planing mill, and band saw-

mill was sold through the sales and executive offices of the corporation maintained in the United States National Bank Building, Portland, Oregon. The corporation also maintained a sales office in San Francisco.

Balance sheets of the corporation contained in its income tax return for the fiscal year ended April 30, 1952, and a financial statement for January 31, 1953, set forth assets, liabilities, and stockholders' equity on the indicated dates as follows:

Assets	April 30, 1952	January 31, 1953
Cash	$ 13,457.87	$ 30,738.41
Receivables (less reserve for bad debts)	135,076.99	117,332.76
Inventories	156,765.18	458,112.44
Capital assets (less reserve for depreciation)	567,282.16	521,280.79
Timber (less depletion)	75,603.55	47,549.78
Land	24,635.27	24,635.27
Miscellaneous	19,700.04	10,983.11
	$992,521.06	$1,210,632.56
Liabilities		
Accounts payable	$ 95,833.90	$ 32,263.30
Bonds, notes, mortgages	320,417.29	529,407.60
Accrued expenses	38,432.77	28,114.05
State & Federal income tax	140,055.00	126,389.98
Capital stock	32,000.00	32,000.00
Paid-in or capital surplus	13,986.00	13,986.00
Earned surplus	351,796.10	448,471.63
	$992,521.06	$1,210,632.56

The California Institute for Cancer Research (hereinafter referred to as the Institute) was formed under the name of the "Cancer Research Foundation of California" on April 26, 1945, as a nonprofit, nonstock corporation under the provisions of division 1, part 4, title 12, article 1 of the Civil Code of California for such scientific, charitable and educational

purposes as are set forth in its articles of incorporation. The Institute is an adjunct of the University of California at Los Angeles. On August 25, 1947, its name was changed to California Institute for Cancer Research. On February 25, 1957, the name was change to West Los Angeles Institute for Cancer Research.

The Institute was a tax-exempt organization under the Federal Tax laws at the time the transaction here involved was entered into.

None of the petitioners were founders of the Institute, or had any connection with or interest in the Institute, except that derived from the transaction hereinafter described. Petitioner never had heard of the Institute before he was approached by its representative as hereinafter mentioned.

During the summer of 1952, William B. Boone of the Portland, Oregon office of Dean Witter & Co., investment counselors and brokers, was informed that his Los Angeles office was in touch with a prospective client interested in acquiring or buying small companies. Boone inquired of a number of people including petitioner as to any possible interest in selling. When contacted by Boone, petitioner stated that he was not particularly interested or looking for a sale or for a buyer, but that he would sell if the price was right, to which Boone replied that he had nothing definite in mind, but might come up with something. On August 8, 1952, Boone relayed the Clay Brown & Company prospect to his Los Angeles office and was informed that the parties thought to be interested were not interested. Subsequently, Boone's Los Angeles of-

fice informed him that the Institute might be interested in acquiring Clay Brown & Company. Louis H. Seagrave, who was then chairman of the board of directors of the Institute, came to Portland and conferred with Boone and attempted to meet petitioner who was out of town. Boone then expedited a meeting between Seagrave and petitioner.

Boone received from Seagrave certain circulars or brochures. These circulars or brochures were prepared by Seagrave in consultation with a Beverly Hills attorney. This attorney, now dead, had worked out sales of businesses to Loyola University under arrangements similar to the suggestions in these brochures. Boone compared the qualifications of Clay Brown & Company to those set forth in the brochures, found the company to qualify, and discussed the substance of the brochures with petitioners.

The brochures explained the benefits to the sellers of selling their stock to the Institute and in broad outline set out how the sale would be effectuated. The benefits of persons selling to the Institute were stated therein as follows:

> 1. They can sell their business to the Institute for more than they can sell for cash, for payment over a period of years, frequently with a substantial down payment.
>
> 2. They continue to control the business operation and to draw their regular salary, and retain an interest in the profits as well, until they are ready to retire.

3. They pay only a long term capital gains tax (25% federal).

4. They protect their families from estate, inheritance and final income taxes, which, with their chief assets still invested in the company, would have been ruinous.

5. They avoid the perplexing predicament of either paying prohibitively high personal taxes on distributed corporate earnings, or risking heavy penalties under section 102 for unreasonable accumulation of surplus if earnings are not distributed.

6. They eliminate the risk that after the death of owners, the business may be subjected to a forced sale or liquidated at possible disastrous loss to their families.

7. They avoid the risk of the business being ruined by incompetent management if sold to others for payment on an installment basis, before the owners have been paid in full.

The sale itself was outlined in the brochures generally as follows: All of the stock is sold to the Institute at an agreed price. The Institute gives its note for the purchase price. The corporation is then liquidated and an agreed amount of cash out of the liquidated assets is paid to the sellers as a down payment. A real estate trust deed and a blanket chattel mortgage covering the fixed assets of the dissolved corporation are deposited with the sellers as security for the unpaid Institute note. A new operating company is formed with nominal capital, and this new com-

pany enters into a 5-year lease agreement with the Institute covering all the fixed assets of the old corporation, and agrees to pay an annual rental therefor of an amount equal to 80 percent of the new company's net earnings before taxes. The operating company also acquires the current assets and assumes the current liabilities, and gives its note to the Institute for the amount of the net current assets which note the Institute will, in turn, deposit as additional security with the sellers. The note from the operating company will be subordinated to reasonable bank loans to the operating company. The Institute will pay to the sellers annual amounts equal to 90 percent of all rentals received on its lease of assets to the operating company.

In addition the brochures contained the following observations about the sale transaction: The sellers, as a group, may own a minority interest in the operating company, but none of the sellers may be directors or corporate officers of the operating company. In this case, petitioner, being president of the old corporation, would be employed by the operating company as its general manager at a salary comparable to his old salary, and the other key personnel could carry over from the old corporation to the operating company. The operating company may be controlled by any of the sellers' trusted associates such as lawyers, accountants, etc. Due to internal revenue laws, the lease arrangement with the operating company may not exceed 5 years. However, a new lease may be entered into with another company, with other owners, officers,

and directors, in which the present sellers can likewise n a minority interest. The sale by the sellers to the Institute and the agreement on the lease between the Institute and the operating company must be at complete arm's length with no overlapping of officers or directors. Under the arrangement, the rental income received by the Institute is tax exempt. Also, if not more than 30 percent is paid to the sellers on the note in the first year, the transaction qualifies as an installment sale, and the taxes on the long-term capital gain resulting are due only in installments proportionate to the amounts paid on the note in any one year.

Boone wrote a letter dated November 28, 1952, to Seagrave in which he:

(1) Related his contacting of petitioner and enclosed financial statements of Clay Brown & Company, together with a photograph of the Clay Brown & Company plant.

(2) Invited Seagrave to visit the plant site at Fortuna, California, meet with petitioner and inspect the property.

(3) Relayed petitioner's offer of 32,000 shares at $40 per share ($1,280,000) with a cash down payment or, in the alternative, without a down payment, $45 per share ($1,440,000).

Seagrave went to Eureka, California, where petitioner met him at the airport and took him to the mill, and over the area in general to inspect the type of timber grown in the region. Seagrave spent 1½ or 2 days looking over the property and then returned to Los Angeles.

During the early part of the negotiations petitioner received advice of counsel concerning the tax consequences of the proposed sale, such advice being set forth in an 11-page memorandum to petitioner from the law firm representing him. In the memorandum the tax-exempt status of the Institute and the deductibility of the rent by the lessee corporation, as well as the long-term capital gain qualification of the amounts received by the shareholders of Clay Brown & Company, were covered. It was therein stated that "[t]he more the deal is a straight sale of the stock of Clay Brown & Company by you, the better your tax position," and the fact that the amounts received by the sellers will be derived from and limited to existing corporate assets and future corporate earnings is not inconsistent with a bona fide sale of the stock. However, petitioner was warned not to acquire an interest in the operating corporation other than that necessary to secure the unpaid balance of the purchase price for the stock. In this respect it was suggested that petitioner have a management contract with the operating corporation to run only for the duration of the pay-out period and that this contract not be tied in as a definite condition in the sale of the stock. It was further stated that "the feature which makes the proposal of the Institute possible is the fact that the new corporation will be able to deduct the rental payments paid the Institute but yet such rental payments will be exempt from taxation when received by the Institute," because other than for this feature the transaction could just as easily be consummated with any third party instead of

the Institute. It was suggested since the tax-exempt status of the Institute was an integral part of the transaction that petitioner make sure a definite ruling from the Treasury Department has been or will be obtained in this regard.

The ensuing negotiations between Seagrave and petitioner encompassed the following:

(a) A letter, dated December 17, 1952, from Seagrave to petitioner, which stated in part:

> Our difficulty is the price, or to put it another way, we feel that a $250,000 premium over reconstructed values is perhaps all a purchase will stand, especially since average earnings before taxes of $360,000 would be required to pay off a price of $1,300,000. Earnings of $360,000 per annum are a little higher than your own idea of $350,000. Incidentally, earnings before taxes for the two and one-half years to October 31, 1952, averaged about $300,000 per annum, but if we were to add back to the year ended April 30, 1952 the amount of $150,000, which would probably not be far from the amounts charged to expense for items which could have been capitalized, and assume net earnings for the current year would aggregate $350,000, the three-year average would be about $350,000.
>
> On the other hand, there is another angle not to be overlooked, namely, the prospective earnings of the new lessee company, in which stockholders of the present company could own nearly 50%. Assuming net before taxes of $350,000, earnings per annum of the new company after payment of

rental would be $72,000. Assuming that income taxes for such an amount of earnings average .33⅓% the net to surplus would be $48,000 a year or $240,000 for the five year period. The net equity accruing to the 49% interest in the new lessee company would amount to $117,000 additional. This would increase the total proceeds of the sale to $1,417,000, which is the equivalent of $44.28 a share.

(b) By another letter dated December 17, 1952, Seagrave requested a pro forma balance sheet for Clay Brown & Company for October 31, 1952, substituting values that Seagrave and petitioner had discussed and also requested a copy of the complete audited statement for April 30, 1952. The audited statement was sent to Seagrave on December 22, 1952.

(c) By letter dated December 23, 1952, Booth sent to Seagrave the requested pro forma balance sheet for Clay Brown & Company as of October 31, 1952, wherein the statement of assets was brought up to date and adjusted values for the assets were substituted in place of book values and certain expense items were capitalized. The total adjusted value for the corporate assets shown on the pro forma balance sheet was $1,825,032. The total liabilities at this time were approximately $769,000, which figure had been previously conveyed to Seagrave, resulting in a net worth of approximately $1,050,000 for October 31, 1952. The corporate liabilities mentioned above included $125,000 in notes owed by the corporation to petitioner and his wife.

(d) The appraised values used for the pro forma balance sheet, to which the above-mentioned adjustments were made, were taken from an appraisal made by the General Appraisal Company dated July 21, 1951, which appraisal was supplied to the Institute. The appraisal set forth the following asset values:

New Replacement	Depreciated	Insurable
$760,545.44	$650,447.10	$556,764.49

The "new replacement" value, as adjusted, was the one utilized in arriving at the $1,050,000 net worth mentioned above. In a letter dated January 7, 1953, Seagrave requested the appraisal be brought up to date and such was accomplished 1 week later by the General Appraisal Company. The supplemental appraisal, based on the original appraisal for insurance purposes, set forth the following asset values:

New Replacement	Depreciated	Insurable
$836,759.43	$703,523.88	$585,636.62

Seagrave met with petitioner in Portland for negotiations which lasted several days. The principal point of discussion was the price. The price ranged from the initial asking price of about $1,500,000 which included the two notes payable to petitioner and his wife in the total amount of $125,000 down to the $1,300,000 including the $125,000 of notes, which was eventually agreed to. At no time during the discussions between petitioner and representatives of the Institute concerning the price of the stock was any mention made of interest on the deferred payment or an increase in the purchase price in lieu of interest.

Both parties considered the amount to be paid for the stock in excess of the reconstructed net worth of the corporation in terms of going concern value and earnings record. At one point in the negotiations Boone felt that the whole deal was going to fall through.

Minutes of meetings of the Institute's board of directors reflect the following details, among others, regarding the prospective transaction with the selling shareholder:

(a) The minutes of January 6, 1953, relate that the chairman (Seagrave) read a summary of the situation affecting Clay Brown & Company, and that after Seagrave obtained additional information, supplemental statistics, and documentary data, he would present these to the Institute's committee on industrial investments. The summary referred to above, among other things, states:

> 16. Assets as appraised by General Appraisal Co., July 1951, with adjustments for items since capitalized, expensed or not included in appraisal, result in net worth of $1,049,877. To this can be added $15,000 of equipment to be transferred to company making total of $1,064,877. Six percent interest on deferred balances, assuming an average of $60,000 earnings per annum would total $237,112.
>
> | | |
> |---|---|
> | Total worth | $1,064,877 |
> | Interest | 237,112 |
> | | $1,301,989 |

The interest on deferred balances was computed as follows:

		6%
Price	$1,300,000	$ 78,600
1st year payment	259,200	
Balance	$1,040,800	$ 65,080
2nd year payment	259,200	
Balance	$ 781,600	$ 46,896
3rd year payment	259,200	
Balance	$ 522.400	$ 31,344
4th year payment	259,200	
Balance	$ 263,200	$ 15,792
5th year payment	263,200	
	-0-	$237,112

(b) The minutes of January 27, 1953, set forth a resolution which appointed a legal committee to go over a proposed purchase agreement and lease and license agreement, both documents being integral parts of the transaction with petitioners, and make any revisions they felt to be to the best interests of the Institute and to pass and approve other documents in connection with the proposed purchase. There were further resolutions authorizing the president and secretary to execute the purchase agreement and the lease and license agreement as they had been outlined subject to changes made with the approval of the legal committee. Attached to the minutes of January 27, 1953, were the following:

(1) A statement by Seagrave that petitioner had advised him as follows:

> He advised me that the new lessee California corporation to be known as Fortuna Sawmills, Inc.,

would have initial paid in capital of $25,000, but that it had an authorized capital of $50,000, and that an additional $25,000 would be paid in, if found necessary.

He also stated that he was a signer personally on the mortgage, and that he would also be a personal signer on the new mortgage to the U. S. National Bank, which would be for approximately $101,000, to which it had now been paid down. He hopes to arrange this mortgage on a five year basis, which would make the annual service of it about $23,000, and have the effect of increasing the net current assets by $80,000. If the bank does not make that arrangement, he feels sure that the bank will make it a three-year loan, on which the annual service would be about $38,000, as it has been.

Mr. Brown advises that he has been assured by the U. S. National Bank that it will continue to lend on logs and lumber, as in the past, with a line up to $400,000.

Mr. Brown read me a memo detailing the working funds they could rely on, which I have reduced to a memorandum, attached hereto. He says that he is in a position to provide funds, or to lend his personal credit to insure adequate funds. He thinks the working capital position will not be as much of a problem as it has been in the past.

(2) An earnings' summary of Clay Brown & Company as follows:

1.	Company began sawmill operation May 1, 1950		
2.	Net before taxes:		
	Year ended April 30, 1951	$415,533.	
	Year e. led April 30, 1952	145,078	(nearly $70,000 expenses)
	Six months to Oct. 31, 1952	207,567	
		$768,000	
	Average annual earnings before taxes	307,270	
	Capital items expensed during 2½ years:		
	Supplies & Tools on hand	$25,000	
	Other items	33,000	
	Labor and const. lumber	40,000	
		$98,000	
	Average annual	32,500	
	Total average annual earnings	$339,000	

(3) Statements by Seagrave as follows:

* * * * *

15. Earnings of an average of $360,000 would pay out purchase price in five years.

* * * * *

17. Clay Brown has a good reputation in Portland, Oregon, and generally throughout the lumber and plywood industry. Mr. Carvel Linden of the U. S. National Bank, Portland, stated to me January 14, 1953: "Clay Brown is a top operator. His situation is clean. I have advised him, solely because of his tax burden, to sell to you if he could come to terms with you. We think that his achievement in starting this lumber company, and producing and selling profitably the first month, and 26,400,000 of the first year at a net profit before taxes of $415,553 is a real achievement."

The Institute had approximately two dozen proposed business acquisitions brought to its attention by various brokers in Los Angeles and the Institute selected two, Clay Brown & Company being one of them. The primary motivation of the Institute in purchasing the stock of Clay Brown & Company was the prospect of ending up with the assets free and clear after the purchase price had been fully paid, which would then permit the Institute to convert the property into money or use in cancer research. The officers of the Institute felt that the purchase price would be paid off in 5 years.

On January 17, 1953, one of petitioner's attorneys sent a letter to the Institute's legal advisor which stated as follows:

> Enclosed is our draft of a proposal to the Institute. We understand that the purchase price will be determined in the near future. As noted in the proposal, it desired to liquidate Clay Brown & Co. and start operations with the lessee corporation by February 1, 1953.
>
> It may now be in order for the Institute to make inquiry of us as to the availability of the operating lessee corporation. We will be able to furnish such a corporation, which will be a California corporation called "Fortuna Saw Mills, Inc." Such inquiry may be addressed to Fortuna Saw Mills, Inc., c/o Calvin N. Souther, 1001 Board of Trade Building, Portland 4, Oregon.

By letter dated January 24, 1953, petitioner made a proposal to sell the Clay Brown & Company stock to the Institute for a determined price and set out a procedure whereby the entire transaction could be consum-

mated. The board of directors of the Institute decided to decline petitioner's proposal and instead, as mentioned above, set about to finalize its own draft of a purchase agreement and lease and license agreement, both of which had been prepared by its attorney in consultation with Seagrave. A final draft of the purchase agreement was approved by the Institute's legal committee appointed under the resolution adopted at the January 27, 1953, directors' meeting.

Under date of February 4, 1953, the purchase agreement, approved by the Institute's legal committee, was executed by the Institute as buyer and petitioner, representing himself and the other stockholders, as seller. The agreement provided for the sale of the 32,000 shares of the Clay Brown & Company stock and two promissory notes owned by petitioner and his wife in the total amount of $125,000 for a price of $1,300,000, represented by a nonnegotiable note in that amount. The agreement provided generally as follows: A balance sheet for Clay Brown & Company will be made as of January 31, 1953, and the seller agrees to indemnify the Institute against any loss arising out of any liability not set out in the balance sheet except that liabilities for income and excess profits taxes and contract renegotiations in excess of the reserves therefore on the balance sheet are not included in the seller's agreement of indemnity but that any such excess liabilities will serve to reduce the principal amount of the note. The Institute will liquidate Clay Brown & Company and shall pay the seller $5,000 in cash, execute a lease and license agreement with Fortuna Saw Mills, Inc. (hereinafter referred to as Fortuna), and sell all the remaining

assets, other than the leased assets and the $5,000 cash, to Fortuna subject to all the liabilities of Clay Brown & Company other than the $125,000 of notes for an amount equal to the net amount of the assets transferred. Fortuna, in turn, is to assume the above-mentioned liabilities and execute its note to the Institute in payment for the assets. As security for the note given the seller, the Institute will execute and deliver to the seller a real estate mortgage or deed of trust and a chattel mortgage covering the real and personal property received by the Institute upon the liquidation other than assets sold to the lessee, as well as after-acquired property. The Institute will also assign its rights under the lease and license agreement with the lessee and the purchase note executed by the lessee to the seller and will further make a defeasible assignment of all patents, patent applications, and trademarks to the seller. The Institute is to pay the seller 90 percent of the royalties and rents received in cash by the Institute from its lessee, Fortuna, or any successor lessee under the lease until the note is paid in full. However, the Institute will be obligated to make payment on the principal note only out of the 90 percent of the rents and royalties it receives from its lessee. If not sooner paid in full, the promissory note will be due and payable January 31, 1963. The unpaid balance of the note shall bear no interest before maturity but thereafter shall bear interest at the rate of 5 percent per year. In the event the Institute shall fail to pay the seller a total of $250,000 during any 2 consecutive years of the lease, the seller shall have the right to declare the entire unpaid balance due. In the event of any default by the Institute the

seller may proceed to enforce payment of the unpaid balance against the collateral held by seller as security, and only against such collateral. No sale by the Institute of any assets received on the dissolution of Clay Brown & Company, other than those assets sold to Fortuna, will be effected without the prior consent of the seller.

Pursuant to the purchase agreement, the Institute issued a non-negotiable, non-interest-bearing note for $1,300,000 payable to the sellers ($125,000 for the notes owned by petitioner and his wife and $1,175,000 for the stock). Also, as contemplated in the transaction: A deed of trust, chattel mortgage and general assignment of intangibles were executed by the Institute under date of February 4, 1953.

The stock record book of Clay Brown & Company reflects the cancellation of all issued certificates for shares of stock as of February 4, 1953, the issuance of a new certificate in the amount of 32,000 shares to the California Institute for Cancer Research, Certificate No. 18, dated February 4, 1953 which certificate bears the following typed legend:

> Cancelled March 14, 1953 upon complete liquidation of the corporation pursuant to resolutions adopted by stockholders and directors on February 4, 1953

and the endorsement dated March 13, 1953, of the California Institute of Cancer Research as follows: "Certificate being returned for concellation."

Also under date of February 4, 1953, petitioner and the other three directors and officers of Clay Brown &

Company resigned and directors associated with the Institute were elected. Formal documents looking to the dissolution of Clay Brown & Compnay were executed by the directors representing the Institute. Among the various documents prepared for this purpose were resolutions by Clay Brown & Company to dissolve, adoption of the dissolution resolution by the Institute, a grant deed from Clay Brown & Company, Bill of Sale and Assignment for personalty and a general assignment from Clay Brown & Company to the Institute covering cash, receivables, inventory, etc. Resolutions dissolving the company, were filed, title report changed, and United States Treasury Department forms filed.

Under date of February 4, 1953, the Institute recorded the following entries reflecting the transaction:

Entry recording purchase of stock:		
Investment in stock of Clay Brown & Co.	$1,175,000	
Notes Receivable—Clay Brown & Co.	125,000	
Notes Payable Re. Fortuna Sawmills, Inc.		$1,300,00
To record purchase of all of issued and outstanding stock of Clay Brown & Co. (32,000 shares) together with two promissory notes owned by Clay and Dorothy E. Brown and executed by Clay Brown & Co.		
Entry recording liquidation:		
Current assets transferred to operating company	$ 617,115.72	
Investment in fixed assets	780,969.88	
Investment in timber	15,008.32	
Investment in timber purchase contract	104,991.68	
Excess of cost over appraisal value of assets leased to Fortuna Sawmills, Inc.	373,038.33	
Deposits	51.00	
Current liabilities transferred to operating co.		$ 499,563.6
Long term debt transferred to operating co.		91,611.2
Notes Payable, stockholders		125,000.0
Investment in stock of Clay Brown & Co.		1,175,000.0
To record receipt of assets and assumption of liabilities upon liquidation of Clay Brown & Co. as of 2/4/53		

During the negotiations with Seagrave prior to execution of the purchase agreement, it was known that an operating company was to be formed, without any decision having been made as to who would form such company. Actual formation of the operating company was considered at a meeting in Portland, Oregon, in December 1952, attended by petitioner, Seagrave, Charles W. Booth, secretary-treasurer of Clay Brown & Company, and Calvin N. Souther, attorney for petitioner and Clay Brown & Company. At this meeting Seagrave was asked if the Institute wanted to provide an operating company or had any suggestions in that respect. Seagrave had no suggestion. When petitioner was asked if he had someone in mind, he turned to Souther and inquired whether Souther would be willing to supply the operating company, Souther being familiar with the area in general through his representation of petitioner in connection with Humboldt Plywood Corporation, a prior business venture of petitioner in the same coastal region of northern California. At that time or sometime thereafter Souther acceded to petitioner's offer.

Fortuna was formed as a California corporation on January 26, 1953, with authorized capital stock of 2,500 shares, par value $10 per share. All of these shares were issued and outstanding, and were owned 2,000 shares by Souther and 500 shares by Kinsey. The officers and directors of Fortuna were:

Calvin N. Souther	president and director
Raymond P. Underwood*	vice president and director
William H. Kinsey	secretary and director

*Underwood is a member of the same legal firm as Souther and Kinsey.

Souther paid into Fortuna $25,000 for all of its stock. The 500 shares owned by Kinsey were subsequently purchased by him from Souther. The $25,000 paid by Souther into Fortuna was out of his own personal funds and was not obtained directly or indirectly from petitioner or any of the other Clay Brown & Company stockholders. Neither petitioner nor any of the other selling shareholders owned any stock interest in Fortuna.

Upon receipt of the Clay Brown & Company assets, subject to the liabilities, as liquidating distributions, the Institute did the following:

(a) Paid $5,000 cash upon the principal note.

(b) Executed a 5-year lease and license agreement with Fortuna.

(c) Sold to Fortuna all the current assets received by the Institute upon liquidation of Clay Brown & Company, except the $5,000 in cash mentioned in subparagraph (a) above, which assets were transferred to Fortuna under a general assignment dated February 4, 1953.

(d) Obtained an assumption agreement from Fortuna dated February 4, 1953, whereunder Fortuna assumed the liabilities of Clay Brown & Company (except the Brown notes in the amount of $125,000) and

wherein Fortuna agreed to pay the Institute an amount equal to the excess of the assets received over the liabilities assumed. Such excess was determined by the audit of Clay Brown & Company as of January 31, 1953, made puusuant to the purchase agreement. The excess subsequently determined by the audit was evidenced by the promissory note of Fortuna dated May 15, 1953, in the amount of $20,991.79.

The 5-year lease and license agreement between the Institute and Fortuna required Fortuna to pay to the Institute in rent and royalties an amount each year equal to 80 percent of the net profits resulting from the use and occupancy of the demised premises. The agreement additionally provided in general as follows: The net profits were defined as profits before depreciation and income, franchise, excess profits or other similar Federal or State taxes. Lessee shall compute net profits for each semiannual period and should a loss result from operations during any semiannual period, any subsequent profits may be applied to offset such loss. Lessor may at its option cancel the lease in the event the lessee shall not have paid lessor a total of $277,778 as rental and royalties during any 2 consecutive full annual periods. Lessee shall exert its best efforts to cause the demised premises to be productive of the highest possible net profits consistent with good business judgment but the rentals shall accrue only in the event that net profits are earned through the operation of the demised premises. Lessee alone shall bear any and all losses incurred by it in the operation of the business. Lessee shall maintain the demised premises in a good state of repairs, shall pay all general property

taxes levied against the premises, and keep the premises adequately insured. The lease contract will not be assigned by lessee without the consent of the lessor. During the term of this lease the majority of the voting stock of lessee must be held only by such persons as are approved by lessor. Lessor is the owner of the name and goodwill of Clay Brown & Company and lessee is given the right to use that name in the conduct of its business during the term of this lease. Until the principal note in the amount of $1,300,000 payable to the former shareholders of Clay Brown & Company has been paid in full, this lease shall not be amended without the consent of petitioner. Lessee agrees to enter into an agreement with petitioner whereby petitioner shall be employed as general manager of lessee until the expiration or sooner termination of the lease.

Pursuant to the lease and license agreement, resolutions were adopted by Fortuna's board of directors authorizing employment of petitioner and other key Clay Brown & Company personnel. Under date of February 4, 1953, petitioner executed a written employment agreement designating him as general manager of Fortuna for a term of 5 years at an annual salary of $25,000 and restricting him from activity competing with the business. Other key Clay Brown & Company personnel also remained at their jobs. No personnel from the Institute were employed by Fortuna.

Approval, satisfaction, and execution of the voluminous set of documents by the various advisors and parties lasted several weeks beyond the stipulated date of the transaction. Near the end of the task, on February 21, 1953, petitioner's attorney wrote to the legal

advisor of the Institute with respect to a proposal by the Institute to amend the deed of trust and chattel mortgage by deleting a requirement that the Institute shall keep the subject property in a good state of repair, fully insured, and pay all taxes, etc. Petitioner's attorney stated that the usual deed of trust and chattel mortgage includes the above-mentioned provisions and that such obligations are the primary obligation of the mortgagor (the Institute) even though such obligations are assumed by the mortgagor's lessee (Fortuna). He further stated as follows:

> It is the intent of the selling stockholders that such provision in the deed of trust and the chattel mortgage will not be personally enforced against the Institute but will only be used as constituting a default triggering a foreclosure of the security. Therefore if it would help matters if Clay Brown et al. gave a letter to this effect, this might be arranged.
>
> If for any reason the lease to Fortuna Sawmills, Inc. should be terminated and the Institute should not be able to immediately re-lease the properties, it is my understanding that the Institute would turn the properties back to the selling stockholders without the necessity of any foreclosure on the security. If this is the case then it would seem that the obligations contained in the subject provisions would never have any affect upon the Institute, because their only purpose is to trigger a default and as before stated the Institute plans to turn back the properties in any event so whether there is a default seems immaterial.

In short, this seems to be one of those situations where one party (Clay Brown et al) want a provision included on the theory it will not come into effect or create any obligation unless an unusual situation arises which the other party (the Institute) claims will never arise; while on the other hand the other party (the Institute) wants the provision deleted because it feels that there is no necessity for same. If the foregoing is a correct analysis of the situation we wish to suggest that there may be a reason of mutual interest to the Institute why the provisions should be included. For tax reasons we want the transaction to look as much as possible like an ordinary purchase of stock by the Institute and the leasing of the assets received upon liquidation to an independent lessee. I believe the maintenance of this picture will be helped by the deed of trust and mortgage containing the standard provisions and might be hurt where the Institute transfers all of its obligations in respect to maintenance of the property to the lessee. We have done all we could to help the tax picture, such as not having Clay Brown own any stock in the lessee corporation, and we believe that inclusion of the provisions might have a beneficial effect in this same direction.

By letter dated February 26, 1953, the selling shareholders conveyed to the Institute their assurance that they would not enforce against the Institute personally its obligation to maintain the demised property but in case of such default the selling shareholders would only be entitled to proceed with foreclosure.

Neither petitioner nor any of his representatives ever sought to find out about the Institute's financial condition at the time of the transaction. At that time the Institute's financial resources fluctuated from nothing to $200,000 or $300,000 depending upon the demands of the university for research. The Institute's funds are expended almost exclusively for cancer research, if not solely for such purpose.

The changeover from Clay Brown & Company to Fortuna was accomplished without any shutdown of the mills, disruption in production or the mechanics of operation. No changes were made in personnel below the level of directors and officers. The customary steps a new corporation takes in entering the business world were accomplished, i.e., bank accounts were set up, registration with the various agencies such as unemployment was changed, insurance policies were changed, the name on the door of the Portland office was changed, and the telephone listing amended. A whole new set of books was set up by Fortuna. A printed notice was sent to the trade relating the changeover from Clay Brown & Company to Fortuna. The stationery was changed by overprinting "Fortuna Sawmills, Inc. successor to" in the space above the "Clay Brown & Company" on the letterhead. Record keeping remained at the Portland executive office. The procedure now was for Fortuna to remit to the Institute its check for 80 percent of the net profits as per the lease and license agreement and for the Institute to remit its check for 90 percent of the amount received from Fortuna to the former shareholders of Clay Brown & Company as per the purchase agreement.

Fortuna harvested over 20,000,000 feet from the timber interests assigned to it by the Institute which the Institute had received upon liquidation of Clay Brown & Company. This is substantially more than the 15,000,000 feet estimated on the balance sheet showing adjusted values for assets as of October 31, 1952. Also, the amount per thousand feet used in determining adjusted values was $8.20 per thousand board feet whereas Clay Brown & Company had received an independent appraisal as of May 1, 1952, of $9 per thousand board feet.

The assets of Clay Brown & Company were subject to a mortgage to the U. S. National Bank of Portland, Oregon in participation with the Reconstruction Finance Corporation. The bank and the RFC consented to the transfer of the property by Clay Brown & Company to the Institute, and likewise consented to a lease of the assets by the Institute to Fortuna in consideration for the assumption of the mortgage by Fortuna and petitioner's continuing personal guaranty of the debt.

Petitioner acted as general manager of Fortuna until he resigned effective October 31, 1954, to become the president of M and M Wood Working Company. Petitioner received a salary of $40,000 per year as president of M and M Wood Working Company. In his resignation petitioner waived his rights under the lease and license agreement to approve any successor to act as manager of Fortuna. Petitioner was retained by Fortuna in an advisory capacity at a salary of $1,000 per month and in such capacity he continued to watch over Fortuna's activities and continued to have the authority to sign corporate checks.

In the conduct of its operations Fortuna borrowed money from the United States National Bank of Portland, Oregon. There were 27 such loans from July 27, 1953, to May 13, 1957, ranging in amounts up to $55,214. One of the loans, for $50,000, was guaranteed personally by petitioner. The other 26 loans were secured by warehouse receipts or chattel mortgages on logs owned by Fortuna. The bank records disclose that the bank had a file designated "Fortuna Sawmills, Inc.", which was separate both from petitioner's personal file and the file for another one of petitioner's corporate enterprises.

Revenue Ruling 54-420, 1954-2 C.B. 128, was published in the fall of 1954, after Fortuna had been operating under the lease for more than 18 months. Petitioner's counsel brought this ruling to petitioner's attention by letter dated November 3, 1954, in which he recommended that the lease and license agreement between the Institute and Fortuna be amended to eliminate the requirement of a management contract between Fortuna and petitioner and further that the rental paid by Fortuna to the Institute be changed from 80 percent of the net profits to $5 per thousand board feet handled at the mill. It was stated that the $5 per thousand board feet rental would be a fair rental and that, based on the past operations of Fortuna, would produce a larger rent payment than the 80 percent.

In 1955 there was considerable flooding of the Eel River which is adjacent to Fortuna's millsite, causing considerable damage to the mill. At this time George Castera, president of the Institute, contacted a high

ranking Pentagon official with the hope of having the river repaired.

The sales prices of lumber began a steady decline in early 1956 without any corresponding decrease in costs. According to the company books Fortuna incurred a loss of $125,346.89 for the 6-month period November 1, 1956 through April 30, 1957. Market conditions worsened thereafter. The cause for the decline was in part due to a recession in the construction industry and also Fortuna was adversely affected by a change in the railroad rates for hauling freight. The fall in the lumber market in 1957 was not foreseeable in 1953 when the sale transaction between petitioner and the Institute was consummated.

The mill operations at Fortuna were shut down and discontinued on or about June 19, 1957. Operations were never resumed by Fortuna, and in a letter dated December 6, 1957, Fortuna called the Institute's attention to the expiration of the lease on January 31, 1958, and expressed a lack of desire on the part of Fortuna to negotiate a new lease. The Institute was notified that the carrying charges of the shutdown property amounted to $3,200 a month which would no longer be the obligation of Fortuna after expiration of the lease on January 31, 1958. In the letter dated December 6, 1957, it was stated that as of the termination of the lease there would be certain items of prepaid insurance and taxes respecting the assets to be turned back over to the Institute for which Fortuna claimed reimbursement and it was suggested that such reimbursement could be made by way of deductions from

the face amount of the $20,997.79 note which had been executed by Fortuna to the Institute.

Under date of December 12, 1957, petitioner notified the Institute that he was instructing Souther that any payments made by Fortuna on the note in the face amount of $20,991.79 which had been assigned to him as additional security were to be paid directly to him. By letter dated January 10, 1958, petitioner made claim against Fortuna on behalf of himself and the other selling shareholders for the full amount of the note undiminished by any charges or claims which Fortuna might have against the Institute. In reply to this claim Fortuna on January 31, 1958, remitted a check to petitioner in the amount of $17,304.92, being the face amount of the note reduced by the above-mentioned items claimed by Fortuna against the Institute totaling $3,686.87. Fortuna took the position that the note represented a debt owed by Fortuna to the Institute, with petitioner's interest being only for security and therefore any claims Fortuna had against the Institute could be charged to the note. The payment by Fortuna was made subject to the condition that if it were determined that the Institute owed Fortuna another amount, relating to a claim for overpayment of rent by Fortuna to the Institute, Fortuna could take satisfaction out of the present payment to petitioner.

Also in the aforementioned letter dated December 12, 1957, petitioner notified the Institute that a default existed under the mortgage, and that unless the Institute could give some definite assurance prior to February 1, 1958, that it would be able to re-lease the prem-

ises or otherwise dispose of them in a satisfactory manner, petitioner would have no alternative but to foreclose the mortgage.

In a letter dated January 17, 1958, addressed jointly to petitioner and Fortuna, the Institute denied the existence of a default, and asserted an additional rental claim against Fortuna of $94,888.38 for the 6-month period May 1, 1956, through October 31, 1956. The Institute took the position that Fortuna's earnings for the 6-month period ended October 31, 1956, generated rental of $94,888.38 notwithstanding the fact that losses incurred by Fortuna in the second half of the year ended April 30, 1957, resulted in a net loss for the whole year. The letter stated in part as follows:

> It is our understanding that in the temporary withholding of rent due us for the six month period ending October 31, 1956, based upon profit for that period, Fortuna Sawmills, Inc. was acting with the consent of Mr. Clay Brown, such that this procedure would not be used by Mr. Brown or the other sellers to create a default under the terms of our purchase agreement with them dated February 4, 1953. Consequently, we are not aware of any present default under the purchase agreement.

Fortuna answered the Institute's additional rental claim in a letter dated January 29, 1958, wherein Fortuna denied the liability and claimed an overpayment of rental in the amount of $55,948.36, for the full lease term. Fortuna took the position that the rental due the Institute was to be determined from profits

computed on a cumulative basis over the term of the whole lease and that on this basis it had overpaid its rent to the Institute in the amount of $55,948.36.

Petitioner answered the Institute's letter of January 17, 1958, in a letter dated January 30, 1958, wherein petitioner disagreed both with the Institute's claim for additional rental, and with Fortuna's claim of overpayment. Petitioner informed the Institute that if it should be determined that Fortuna actually overpaid the rent so that the Institute was required to reimburse Fortuna, the Institute should not look to the sellers of the stock of Clay Brown & Company for return of any of the purchase price. As for the Institute's denial of a default, petitioner stated as follows:

> Whether a default presently exists under the mortgage should be immaterial by the end of this month since at that time there will definitely be a default under Paragraph VII of the purchase agreement, and also under the provisions of the mortgage obligating you to keep the property insured, etc., if you fail to comply with such obligations on and after February 1, 1958. A default is pertinent only in regard to foreclosure, and I would much rather receive the remaining balance of the purchase price than foreclose on the property. If you are able to suggest any alternative to foreclosure I will be happy to consider same. It is necessary that we all recognize the realities of the situation since some definite decision will have to be made and action taken immediately.

The selling shareholders and the Institute settled their differences by agreement made on June 3, 1958, as of February 1, 1958, providing for the retention of ownership and possession of the property by the Institute with an obligation to pay upon the principal note 90 percent of any net proceeds realized from rental or sale of the property. The agreement provided in addition generally as follows: The sellers are required to pay all sums necessary to care for, maintain, and preserve the property including taxes. The 10 percent of the net proceeds of any lease or sale of the property will be payable to the Institute notwithstanding the fact that the face amount of the principal note, in the amount of $1,300,000 has not been paid. The agreement will extend to December 31, 1958, and thereafter unless the sellers give notice of termination. Upon a written notice of termination the agreement will remain in effect for a reasonable period beyond the designated termination date if on such date there is pending a negotiation or proceeding for condemnation of the property or if the Institute is engaged in negotiating a sale of the property upon terms satisfactory to the sellers to permit a conclusion of such proceedings or negotiations. In any event the Institute will be allowed a reasonable time beyond the stated termination date to effect a forced sale of the property at public auction. During 1958 the Institute leased the properties for a short period to a lessee other than Fortuna on the basis of $3.50 per thousand feet of lumber manufactured. Sometime prior to January 24, 1958, the Division of Highways, State of California, had been considering condemning part of the millsite at Fortuna, California. The Institute was

able to prevail upon the highway department to purchase the entire property rather than to condemn a part. In July 1959, the property was sold by the Institute to the highway department for $300,000, payment being made to the parties pursuant to the agreement, effective February 1, 1958, as follows:

Expenses of sale	$ 8,781.68
10 percent of residue to Institute	29,121.83
90 percent of residue to promisees of principal note	262,096.49
	$300,000.00

The $8,781.68 expenses of sale included $8,765.48 paid to one of petitioner's corporate enterprises in reimbursement for payments for taxes and maintenance of the property which it had made.

Upon sale of the assets to the highway department and the disbursement of the proceeds, the entire sales agreement between the selling shareholders and the Institute was terminated.

The following table shows Fortuna's net profits before payment of rent and income taxes, the amount of payments made by Fortuna under the lease and license agreement to the Institute and the amount of payments by the Institute to the shareholders on its note for the years involved in the sale transaction:

Period covered	Fortuna Net Profit Before Rent and Income Taxes	Payments by Fortuna to Institute per Lease and License Agreement		Payments by Institute on Promissory Note
		80 Percent of Net Profit	Other	
February 4, 1953-April 30, 1953	$ 46,206.91	$ 36,945.53		$ 38,250.98
May 1, 1953-April 30, 1954	(4,748.23)	7,496.84	[1]$ 1,796.08	13,829.14
			[1]84.23	
			[2]5,201.67	
May 1, 1954-April 30, 1955	521,585.16	396,019.61	[2]4,098.00	360,515.65
May 1, 1955-April 30, 1956	331,867.84	263,387.55	1,450.00	238,498.80
May 1, 1956-April 30, 1957	(6,736.42)	142.50		
Sub-totals	$888,175.26	$703,992.03	$12,629.98	$651,094.57
May 1, 1957-October 31, 1957	(83,681.21)		[3]20,849.29	20,849.29
November 1, 1957-April 30, 1958			[2]989.00	989.00
May 1, 1958-October 31, 1958				
November 1, 1958-April 30, 1959			[4]1,102.50	1,102.50
May 1, 1959-October 31, 1959				$674,035.36
				[5]262,096.49
				$936,131.85

[1]Workmen's compensation dividend.
[2]Proceeds from sale of capital assets.
[3]Settlement of $20,991.79 promissory note given to Institute by Fortuna.
[4]Proceeds of sale of right-of-way and sale of capital assets.
[5]Proceeds of sale of assets to California Highway Department.

Each petitioner determined his gain on the sale of his stock by treating the amount to be received as his proportionate share of $1,175,000 (the $1,300,000 face amount of the note less the $125,000 of notes) and subtracting therefrom the basis of his stock. Each petitioner reported his gain upon the installment basis on his returns determining the amount that constituted gain in each year by applying to the amount he received from the Institute in that year the percentage that his total gain on the sale bore to the total amount to be received. Each petitioner treated his gain in each year as long-term capital gain. Respondent, in his notice of deficiency, computed the gains from the transaction by the same method petitioners had used on their returns but added to each petitioner's basis for his stock his allocable portion of the amount of $1,500.82 representing legal fees paid by Clay Brown & Company in 1953 which respondent determined constituted a constructive pro rata dividend to petitioners. Respondent determined that each petitioner's gain arising from the transaction in each year as so computed constituted ordinary income.

Some of the facts have been stipulated and are found accordingly.

Ultimate Findings.

The agreement entered into between petitioners and the Institute under date of February 4, 1953, constituted a bona fide sale of petitioners' stock in Clay Brown & Company to the Institute for a price arrived at in an arm's-length transaction. The amounts received by petitioners from the Institute pursuant to this agreement are proceeds from the sale of their stock.

The principal amount of the note given by the Institute to petitioners in payment for their stock in Clay Brown & Company and the note of that corporation to Clay B. Brown and Dorothy E. Brown was $1,300,000. This note was without interest until maturity. In arriving at the sales price of the stock, no consideration was given by the parties in their negotiations to an amount in lieu of interest.

Opinion.

The primary issue presented is whether petitioners are entitled to treat the gain realized by them upon the disposition of the Clay Brown & Company stock as a long-term capital gain. Respondent contends in the alternative that if it should be decided contrary to his determination that the gain realized by petitioners is long-term capital gain, part of the amounts received by petitioners is properly attributable to interest and thus taxable as ordinary income.

Petitioners' position is that the gain they realized resulted from the sale of a capital asset, the stock of Clay Brown & Company, held for over 6 months and, consequently, they are entitled to report the gain as a long-term capital gain.

Respondent first argues that, if it be assumed that the petitioners have, in fact, sold their stock in accordance with the numerous documents which purport to reflect such a sale, the petitioners retained such an economic interest in and control over the property sold that the transaction should not be treated as resulting in long-term capital gain for purposes of Federal income tax, citing Gregory v. Helvering, 293 U.S. 465 (1935);

Higgins v. Smith, 308 U.S. 473 (1940); Griffiths v. Helvering, 308 U.S. 355 (1939); and Burnet v. Harmel, 287 U.S. 103 (1932).

Respondent asserts that in the transaction the selling shareholders retained control of the corporate assets via the security instruments executed by the Institute and the management contract between Fortuna and petitioner and retained control of the profits by receiving them as payment on the purchase price. On the other hand, respondent observes, the buyer, the Institute, neither put up assets of its own nor assumed any risk with respect to the purchase.

Respondent's second contention is that the numerous documents present in this case, though cast in terms of, and presenting a picture of, a sale, did not, in fact, represent the substance of the transaction intended by the parties, the transaction in substance being an arrangement whereby petitioners would siphon off the profits from the corporate business at capital gain rates and then terminate it by the Institute turning back the properties to petitioners. Respondent asserts that it was the intention of the parties that the payments by the Institute on the purchase price at the rate of 90 percent of the Institute's receipts from Fortuna would be stopped and the property reacquired by the petitioners any time the petitioners deemed such reacquisition appropriate. Respondent contends that this result could be accomplished under a tacit agreement to this effect which he asserts existed between petitioner and the Institute or by petitioner's having Fortuna withhold payments to the Institute, thus "triggering" a default on the purchase agreement.

Both of respondent's contentions are based on a lack of substance to the purported sale, his first argument assigning as a reason that the transaction did not change the control over and economic benefits from the property and his second that it was never the intent of the parties that the Institute actually acquire the properties.

The facts in the instant case do not support either of respondent's contentions. Petitioners by the transaction here involved parted with their equitable ownership of the assets when they transferred their stock to the Institute and became the creditors of the Institute with mortgages and a management contract as security for the payment of the purchase price of the stock. This change of interest constitutes a change of economic benefits thus distinguishing this case from the cases relied on by respondent.

Griffiths v. Helvering, supra, and Higgins v. Smith, supra, each involved a transaction whereby assets were sold or transferred to a corporation wholly owned by the taxpayer. The Supreme Court held in each instance that the taxpayer by virtue of his 100 percent stock ownership of the corporation had as much economic interest in and control over the assets as if he held them outright. In Burnet v. Harmel, supra, the taxpayer leased oil lands in return for a bonus, i.e., a down payment, and a royalty on all oil produced. The lease was for 3 years and thereafter as long as oil was produced, the oil which had not been extracted to revert to the lessor upon termination of the lease. The Supreme Court held that the transaction did not constitute a sale of the oil in place for tax purposes because the passage

of title to the oil to the lessee was merely incidental to his primary right acquired under the lease which was the right to go upon the land and drill for oil.

In the present case the stock was transferred outright to the Institute and such transfer was basic to the entire transaction. Here there would be no reversion to petitioners of the assets which the Institute received from the stock sold to it unless there was a default in the payments on the notes given for the stock. The interest of the petitioners would continue not infinitum as in Burnet v. Harmel, supra, but only until the purchase price of the stock was paid. Gregory v. Helvering, supra, involved a transaction which the Supreme Court held was "an operation having no business or corporate purpose — a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character * * *." There was a clear business purpose in the instant case on the part of all parties thereto. Petitioners were able to sell their stock at a price agreeable to them, the Institute obtained funds by the retention of 10 percent of the rental payments from Fortuna and expected to obtain funds from the sale of the assets after the note was paid in full, and the stockholders of Fortuna expected that corporation to have income from the 20 percent of its operating profits that it was to retain.

Respondent argues that petitioners would not have been interested in the transaction had they not thought that the profits received on the sale of the stock would be taxable as long-term capital gain. Assuming that respondent's argument in this regard is correct, it does not follow that there was a lack of substance to the

sale of the stock. It may be, as respondent contends, that petitioner would have been unable to sell the stock at as favorable a price to anyone other than a tax-exempt organization. This fact does not indicate that there was no business purpose in the sale. As the court stated in Gregory v. Helvering, supra, "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes or altogether avoid them, by means which the law permits cannot be doubted." Certainly, the right of a taxpayer by legal means to increase the amount received from a transaction over what he might have received from a different transaction is fundamental. So long as a sale to an exempt organization of stock in a corporation engaged in a commercial business is legal, such a sale, where it is in substance as well as in form a sale, is not to be ignored for tax purposes solely because the exempt organization is willing to pay a somewhat higher price than someone else might pay.

The capital gains provisions of the Code constitute an exception to the normal tax requirements and are to be narrowly construed, Raymond Bauschard, 31 T.C. 910, 916 (1959) affd. 279 F. 2d 115 (C.A. 6, 1960), and cases there cited. Even a narrow construction of these provisions does not support a conclusion that they should be inapplicable to a sale to a tax-exempt organization.

Respondent's second argument is based on his assertion that in substance there was no sale, it being the intent of the parties that at some future date the assets would be returned to petitioners. In support of his position respondent relies primarily on statements in a letter written by one of petitioners' attorneys to the attorney for the Institute wherein reference is made to the pos-

sibility that a situation might arise creating a default under the mortgage warranting a foreclosure. The portions of this document relied upon by respondent are set forth in our findings. In our view the reference to returning the properties to petitioners is intended to refer only to the situation in which petitioners would have the right otherwise to foreclose on the properties. George Castera, president of the Institute, testified unequivocally that the main reason the Institute entered into the transaction was that it hoped that the note could be paid off and the Institute obtain the properties which it planned to sell to obtain money for use in cancer research.

Upon consideration of all the evidence in this case we hold that the transaction constituted a bona fide sale by petitioners to the Institute arrived at in arm's-length negotiations and devoid of any tacit understanding of the parties to collapse the deal at a time deemed appropriate by petitioners or of any plan or arrangement for artificially triggering a default.

There is substantial evidence in the record in addition to Castera's testimony to support our conclusion. The Institute was not a creation of petitioners but had been in existence a number of years before the transaction here involved occurred. It was the moving party in seeking a corporation to buy. The Institute took steps to ascertain exactly what it was purchasing. Seagrave spent a day and a half or 2 days looking over the business premises at Fortuna. The Institute requested balance sheets, statements of earnings and asset appraisals from petitioner. Petitioner was requested to bring the balance sheet and asset appraisals up to date. The In-

stitute inquired into petitioner's business reputation. Numerous drafts of the proposed purchase agreement and related documents were made by the parties.

The price of $1,300,000 (including the $125,000 of notes) was the result of real negotiating. It was within a reasonable range in light of the earnings history of the corporation and the adjusted net worth of the corporate assets. The lease and license agreement between the Institute and Fortuna required that the majority of the stock in Fortuna be held only by persons approved by the Institute. In 1955 when the millsite property at Fortuna was damaged by river flooding, Castera contacted a top ranking Pentagon official with the hope of having work done on the river. In 1957 a real dispute arose between the Institute and Fortuna respecting the amount of rent due the Institute. Fortuna was organized with more than nominal paid-in capital and the amount was paid by and the stock held by persons other than petitioners. Since these persons were petitioner's attorneys, it may be that they were willing to organize and finance the operating company in reliance on petitioner's ability as the manager of that company, but this is merely another way of saying that with petitioner as manager, they hoped to make a profit from their investment in the operating company, which certainly is a bona fide business purpose.

These facts and others set forth in our findings negate respondent's contention that the transaction was a sham.

Respondent relies primarily upon Emanuel N. (Manny) Kolkey, 27 T.C. 37 (1956), affd. 254 F. 2d 51 (C.A. 7, 1957), in support of his second argument.

That case involved a factual situation distinguishable in many respects from the instant case. There, the tax-exempt organization was sought out by the seller, the stock was transferred to a new operating company, the stock of which was owned by the tax-exempt organization, with dividends to be paid to the tax-exempt organization, the selling price for the stock was almost four times its fair value, the new operating company was set up with an extremely short cash position, the business was highly speculative, its effectiveness had been impaired by adverse governmental rulings, and the operating company stock was transferred to the original sellers of the old corporation stock after 11½ months. Cf. Estate of Ernest G. Howes, 30 T.C. 909, 925 (1958), affirmed sub. nom. Commissioner v. Johnson, 267 F. 2d 382 (C.A. 1; 1959). On the facts present in Emanuel N. (Manny) Kolkey, supra, the conclusion was reached that there had been, in fact, no sale of the corporate stock but rather that the stock had been contributed to the new operating company as equity capital and the amount received at the time of the purported sale constituted a taxable dividend.

In the present case we have a transaction whereby petitioner parted with their stock to an unrelated company for the considerations covered in the agreements negotiated at arm's length. The following language in Union Bank v. United States, 285 F. 2d 126, 128 (Ct. Cl. 1961), which dealt with a transaction quite similar to the instant case, is equally applicable to the facts here present:

> From the standpoint of the Goldenbergs, they were, before the 1951 transaction, the owners of

valuable properties and a valuable going business. * * * After the 1951 transaction the Goldenbergs had no interest in these assets, except a security interest, the power to take them back in case of default in payment for them. If they increased in value because of general prosperity or business success, or in dollar value because of inflation, the Goldenbergs would get no part of that important incident of ownership. * * * .

We think it is logically and legally impossible for an owner to part with his property, for a consideration, without selling it. The consideration which he gets for parting with his property is not income from the property, but is the price of his parting with the property.

We hold that the profit received by petitioners from the sale of their stock to the Institute constitutes long-term capital gains.

Respondent contends in the alternative that should it be decided that the disposition of the Clay Brown & Company stock qualifies for long-term capital gain treatment, part of the payments received by petitioners from the Institute constitutes payments of interest on the unpaid balance of the purchase note taxable as ordinary income. Respondent states that the factor of interest was contemplated by the parties in arriving at the ultimate purchase price and that the rate so contemplated was 6 percent.

We have found as a fact that interest was not contemplated by the parties in arriving at the ultimate purchase price. Petitioner specifically justified the price he was asking on the basis of the value of the business

as a going concern and its earnings record. The Institute in dealing with petitioner discussed the amount it was willing to pay for the business on a similar basis. The finally agreed price was arrived at in an arm's-length transaction and it was specifically provided both in the purchase agreement and the note executed pursuant thereto that there was to be no interest due on the unpaid balance of the note prior to the date of maturity which would occur on a specified date or an accelerated date upon failure of the Institute to pay a specified sum over any 2 consecutive years, neither of which events occurred. The summary of the statement read by Seagrave contained in the minutes of the meeting of the board of directors of the Institute of January 6, 1953, contains, among other reasons for justifying the price to be paid for petitioners' stock, a computation of the amount that interest at 6 percent on the unpaid balance of the appraised value of the assets would total over a 5-year period. This was merely a part of a statement by a representative of one party to the transaction and formed no part of the negotiations between the parties or the agreement between them as to the purchase price of the stock.

We have consistently refused to consider a portion of a total purchase price as constituting interest where as here the agreement of the parties was clearly for a price without interest. Carl Lang et al., 3 B.T.A. 417 (1926); Elliott Paint & Varnish Co., 44 B.T.A. 241 (1941); and M. C. Parrish & Co., 3 T.C. 119 (1944), affd. 147 F. 2d 284 (C. A. 5, 1945). Cf Brandtjen & Kluge, Inc., 34 T.C. 416, 447 (1960) and cases there cited.

The circumstances in Elliott Paint & Varnish Co., supra, are quite similar to those here involved, the primary distinctions being that in that case the seller had made the unilateral interest computation in considering the price she was willing to take and the purchaser was not a tax-exempt organization. The question in Elliott Paint & Varnish Co., supra, concerned the deductibility of interest by the purchaser. Absent a statutory provision to the contrary, the same rules should govern in determining whether interest is includible in income by the seller as are used to determine whether interest is deductible by the purchaser. Since we have held that the transaction between the petitioner and the Institute was arm's length and was not a sham and that the price negotiated by the parties was not intended to include an element of interest, the factual distinctions between the instant case and Elliott Paint & Varnish Co., supra, are not significant.

We have, in cases in which monthly payments on property designated as rental were held in fact to be payments on the purchase price, found that a part of each payment constituted interest where the evidence showed that the agreement between the parties contemplated a payment in the nature of interest. Judson Mills, 11 T.C. 25, 33, 34 (1948). We have also considered a discount from the face amount of a loan to be deductible as interest. John Randolph Hopkins, 15 T.C. 160, 181 (1950). Cf. M. C. Parrish & Co. supra, in which a note issued at a discount was distinguished from a deferred price which might be higher than a cash price.

Respondent's argument that a part of the payments received by petitioner was in fact interest is again an attack on the transaction as not bona fide, his contention being that interest was actually considered by the parties "but remains hidden behind the veil of documents evidencing the ultimate price of the stock." We have found that interest was not considered in negotiating the price of the stock, that the transaction was bona fide and did in substance as well as form constitute a sale by petitioners of their stock in accordance with the terms set forth in the purchase agreement, a part of which was the provision that the note given to petitioners was without interest.

Even if the evidence supported respondent's contention that the purchase price of $1,300,000 had been shown to contemplate $237,112 of interest, it would not follow necessarily that any portions of the payments made in the years here involved were interest. Where a payment is made on an interest-bearing debt without designation by either party as to whether the amount is to be credited to principal or interest, the payment will first be credited to interest and then to principal, Theodore R. Plunkett, 41 B.T.A. 700-709 (1940), affd. 118 F. 2d 644 (C.A. 1, 1941), but where the parties have agreed as to the allocation of a payment as between principal and interest, their agreement will be recognized. Huntington-Redondo Co., 36 B.T.A. 116 (1937). The rules regarding the application of payments, where more than one debt exists, are that the payment will be applied as the debtor directs but if the debtor fails to make such an application, the payment will be applied as the creditor directs. Chicago

& North Western Railway Co., 29 T.C. 989, 996 (1958) appeal dismissed (C.A. 7, 1958).

It is clear in the instant case that petitioners treated the payments received in the taxable years here involved as payments on the principal amount of the purchase price of their stock and so allocated the payments by treating the full amount of such payments on their income tax returns as receipts of the purchase price of their stock. Cf. Lincoln Storage Warehouse, 13 T.C. 33, 40 (1949), affd. 189 F. 2d 337 (C.A. 3, 1950).

If the evidence did support respondent's contention that $237,112 of the $1,300,000 was intended to be in lieu of interest, it would follow that since there was no contrary agreement between the parties petitioners would be entitled to have their allocation of the payments to principal recognized until the entire principal had been paid. This event not only did not occur in the taxable years here involved but never occurred. The facts show that the total payment received by petitioners at the conclusion of the transaction was only $936,131.85.

Respondent's own determination of the gain as set forth in the notice of deficiency recognizes petitioners' allocation of the amounts received from the Institute and is inconsistent with an allocation of any portion of the payments to interest. Respondent, accepting the method used by petitioners on their returns, computed each petitioner's gain from the transaction by treating the amount to be received for the stock as $1,175,000 which was the face amount of the note less the $125,000 attributable to the notes due to petitioner. Respond-

ent allocated the $1,175,000 to each petitioner on the basis of the percentage of stock he owned to the total stock sold. From the amount to be received by each petitioner as so determined, respondent subtracted that petitioner's basis in his stock and considered the remainder to be the net gain to be received from the transaction. Respondent then applied the percentage which the net gain as computed for each petitioner bore to the total amount to be received by that petitioner to the amount received in each year here involved to determine the taxable net gain for that year. This method of determining the amount of gain received by each petitioner in each year is based on the assumption that the entire $1,175,000 face amount of the note is the price received for the stock. To be consistent with his present contention, respondent should have considered only approximately $927,888[2] to represent the amount to be received for the stock and computed the net gains and the percentage of the payments in each year that constituted gains accordingly. The allocable portion of the interest should have been considered to constitute a separate item of income.

In support of his position respondent cites Wilshire Holding Corporation v. Commissioner, 262 F. 2d 51 (C.A. 9, 1958), reversing a Memorandum Opinion of this Court. In that case the Court of Appeals held that this Court was not precluded by a prior Circuit Court decision in the same case from determining whether under the facts there present an allocation of payments

[2] $1,175,000 minus $237,112 less whatever portion of assumed interest respondent considered applicable to the $125,000 of notes.

made to purchase real estate between principal and interest payments was appropriate. The case is not in point under the facts of the instant case. Here, the parties, themselves, have expressly provided for payment on a purchase price without a provision for interest except under circumstances which did not occur. In Wilshire Holding Corporation v. Commissioner, supra, a transaction in form a rental agreement was held in law to constitute a sale agreement. Under such circumstances the Circuit Court held that consideration could be given to whether, in fact, some portion of the payment should be considered as interest.

We hold that no part of the payments received by petitioners is allocable to interest.

Certain adjustments made by respondent are not contested by petitioners.

Reviewed by the Court.

Decision will be entered under Rule 50.

Withey, J., dissenting: I concur in the dissent of Judge Pierce. It is true that the Institute, prior to embarking upon the "sale" transaction here, made an investigation of Clay Brown & Company as though its intent was to carry out a real sale. In my view, this investigation was part and parcel of the elaborately developed bail-out plan and is nothing more than window dressing. I doubt if the 10 percent "rental" retained by the Institute was in consideration of its services rendered because I do not believe that it rendered any services. I would have held the 10 percent retention to have been in essence a gift.

Turner, J., agrees with this dissent.

Pierce, J., dissenting: The Supreme Court said in Griffiths v. Helvering, 308 U. S. 355:

> We cannot too often reiterate that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." Corliss v. Bowers, 281 U. S. 376, 378. And it makes no difference that such "command" may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. * * *

I am impelled to dissent from the majority opinion herein, because I believe that inadequate effect was given to the foregoing principles, and that the case has been wrongly decided.

I.

The intricate series of transactions here involved is typical of a widely publicized tax avoidance plan, sometimes referred to as a "Bail-Out Plan" or a "Bootstrap Sale."[1] The objective of such a plan is to set up a procedure whereby low-basis stockholders of a close corporation which has large accumulated earned surplus and prospects for good future earnings, might "bail

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[1]Moore and Dohan, Sales, Churches, and Monkeyshines, (1956), 11 New York Univ. Tax Law Review, p. 87; Lanning Tax Erosion and the "Bootstrap Sale" of a Business, (1960), 108 U. of Penna. L. Rev., p. 623; MacCracken, Selling a Business to a Charitable Foundation, 1954 Univ. of So. Calif. Tax Inst., pp. 205, 209.

out" these earnings and future profits at less than the normal tax cost, without disruption of the continued business operations, and with the "sellers" retaining their command and control over such operations while the bail out is in process. An indispensible feature of such a plan is a purported "installment sale" of the business to a tax-exempt charitable organization, through which the plan is operated and the future tax-free business profits are "channeled" back to the "sellers"—without the charity making any investment from its own assets or assuming any personal liability.

Of course, the fact that the plan is devised for tax avoidance purposes is not alone sufficient to condemn it; but this factor does justify close scrutiny of what in reality has been done. As was recently said by the Court of Appeals for the Fifth Circuit in United States v. General Geophysical Co., (10/20/61) .... F. 2d ....:

> These tax avoidance implications do not constitute a license to courts to distort the laws or to write in new provisions; they do mean that we should guard against giving force to a purported transfer which gives off an unmistakably hollow sound when it is tapped. * * *

II.

What happened in the present case may be summarized as follows. The petitioners (consisting of Clay Brown, his wife and three children, and the two Booths—all of whom are herein referred to as the "Brown group") owned all or substantially all the issued and outstanding shares of capital stock of Clay Brown & Company, which had certain lumber interests

and operated a sawmill near Fortuna, California. The aggregate cost basis of the Brown group's investment was only about $42,000; whereas the corporation had, as of January 31, 1953, an accumulated earned surplus of $448,472, and prospects for good future earnings as its timber was utilized and the lumber was sold.

In the summer of 1952 Clay Brown, who was president of the company and also the representative of the Brown group, had a conference with a business promoter who supplied him with brochures pertaining to the bail-out plan of procedure. These brochures pointed out the hazards of heavy tax penalties on the corporation for unreasonable accumulation of surplus, the "ruinous" possible effects of estate and income taxes if the Browns' investment were retained in the business or current dividends were paid, and the advantages of using the bail-out plan to relieve such situation. The upshot was that the Brown group decided to embark on such a plan; specific details for adapting the plan to the particular situation were worked out; a complicated set of interrelated legal instruments was drafted to give effect to the plan; and then, as of February 4, 1953, the following steps were taken:

(a) The Brown group endorsed and delivered all their shares of stock of Clay Brown & Company to the charitable organization here involved (called the Institute), together with $125,000 face amount of promissory notes of said company that were then held by Clay Brown and his wife. The Institute at the same time delivered to the Brown group, as purported consideration therefor, its "promissory note" in the face amount of $1,300,-

000, which was dated to mature about 10 years later, which was nonnegotiable and noninterest bearing; with respect to which the Institute assumed no personal liability whatever for its payment; and on which payments were to be made solely out of so-called "rentals" derived from the future profits of the continuing business, in the manner more fully described. The Institute invested none of its own assets in exchange for the stock; and indeed, it had no such assets available for investment, because its receipts came principally from donations made to it for charitable purposes. Clay Brown did not even inquire regarding its assets or its financial responsibility.

(b) The Institute as "buyer" of the stock, had no discretion whatever as to what disposition it might make of the property; for all details as to such disposition were specifically arranged and provided for in the various predrafted instruments of the plan. These included the following steps which were then followed: (1) The Clay Brown Company was dissolved; (2) $5,000 of the underlying current assets were withdrawn and turned over to the Brown group as a "down payment," in order to set up a purported "installment sale" for the transferred stock; (3) the remaining net current assets were "Sold" for another promissory note to a new thinly capitalized corporation named Fortuna Mills, Inc., which had theretofore been organized in the office of Clay Brown's attorneys, for the specific purpose of taking over and continuing the operations of the former business of

Clay Brown Company; (4) all other assets of the business, both real and personal, were thereupon mortgaged back to the Brown group; and (5) these same assets were than "rented" by the Institute to the new Fortuna Company, under arrangements whereby 80 percent of the net profits of the business, before any allowances for depreciation or for state and Federal taxes, were to be distributed currently to the Institute as "rental," and whereby 90 percent thereof were then to be paid over to the Brown group as purported "credits", on the above-mentioned $1,300,000 note.

(c) Concurrently and as part of the plan, Clay Brown was employed as "general manager" for the new Fortuna Company at an annual salary of $25,000; and further provision was made that, if for any reason he ceased to act as such, his successor would be selected by the Brown group. The powers given to Brown in such capacity were substantially the same as those which he had previously exercised as president of Clay Brown & Company. No property could be sold without his consent. When mortgage loans of the Clay Brown Company were transferred into the name of the new company, Brown personally guaranteed them (for the entire capital stock of the new company was equal only to Brown's first year's salary). And Brown also, on another occasion, personally guaranteed a $50,000 bank loan to the new company.

The new Fortuna Company took over and continued operation of the business, without interruption; and it thereafter continued to operate the same for about 4½ years on the same premises, with the same operating personnel, with both the control and management thereof in the hands of Clay Brown, and with no practical difference except as to name. During said period, it harvested over 20,000,000 feet of timber from the interests which it had taken over from the Clay Brown Company; and it currently paid out its profits, before depreciation and before taxes, in the manner above described.

These operations continued until June 19, 1957, when Fortuna Mills shut down its mill and permanently discontinued business. Thereupon, an appraisal was made of the remaining net assets of the business; and this revealed the salable value of the same to be about $300,000, as compared with the appraisal made prior to the purported "sale" of over $1,000,000.

In July 1959, the entire remaining assets of the business were sold to a third party for $300,000; and out of the net proceeds, the Brown group then received 90 percent, and the Institute received its familiar 10 percent. Thereafter, in accordance with a "settlement" between the Brown group and the Institute, the $1,300,000 "promissory note" of the Institute was canceled; and also all of the "mortgages," "rental agreements," "assignments," and other instruments which had been employed under the plan, were likewise canceled.

The net financial result of the plan's operation was that the Brown group received out of its investment during the time that the plan was in operation, a total of

$936,131.85; and the Institute received nothing except its 10 percent withdrawals from the current distributions which passed through its hands. It is the above amount of over $900,000 which the Brown group has contended should be taxed at the preferred capital gain rates after spreading on the installment sale basis; and it is this amount also which the respondent determined should be taxed as ordinary income from the continued operation of the business, after adjustment for exhaustion of the Brown group's original investment.

III.

When the foregoing intricate series of transactions are viewed in the light of their realities, when consideration is given to who had the command and control over the business, who bore the risks of its operation, and who was entitled to enjoy the substantial benefits therefrom—I believe the same will not support a conclusion that the business actually was "sold" to Institute, or that the Brown group received its share of the profits solely in the capacity of "creditors" of the Institute.

Moreover, it is doubtful whether there was any legally sufficient "consideration"[2] delivered by the Institute.

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[2]See in this connection, 1 Williston on Contracts, 3d Ed. (1957), sec. 112 at p. 445. There Williston, in his discussion of consideration, gives the illustration of a man saying to a tramp: "If you go around the corner to the clothing shop there, you may purchase an overcoat on my credit." Williston says that although the walk might be regarded as a legal detriment to the tramp, yet it is not "consideration" because, on a reasonable interpretation, the walk was not requested as the price of the promise but merely as a condition of a gratuitous promise.

which would support a valid sale. It invested nothing out of its own assets; assumed no personal liability for payment of the $1,300,000 "promissory note"; and became entitled to receive only what was, in effect, a 10 percent "service fee" for its assistance in carrying out the plan. All acts done were for the primary benefit of the Brown group; and the Institute was, in reality, merely an interposed subservient agency (see quotation from Griffiths v. Helvering, supra).

In the leading case of Gregory v. Helvering, 293 U. S. 465, the Supreme Court refused to give effect to corporate transactions which complied precisely with the formal requirements for nontaxable corporate reorganizations, on the ground that the transactions had served no functions other than that of a contrivance to bail out corporate earnings to the sole shareholder at capital gains tax rates. In Commissioner v. Court Holding Co., 324 U. S. 331, the Supreme Court taxed a corporation on the gain from sale of an apartment house notwithstanding a transfer of the house to the corporation's two shareholders before the sale, since it found that the transfer was made solely to set in a more favorable tax form, a sale which in reality was made by the corporation. Similarly, in Helvering v. Clifford, 309 U. S. 331, the Supreme Court taxed a

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See also, Evans v. Rothensies, (C.A. 3) 114 F. 2d 958, wherein the taxpayer "sold" preferred stock to a penniless son-in-law, for a joint-and-survivor annuity of slightly less than the dividends. Nearly all the stock was held in escrow to secure the annuity payments. The court held that the stock transfer was "hardly more than a gift," with retention of a partial interest in the income from the stock for the lives of the "seller" and his wife.

trust grantor on the income of the trust property, since the formal transfer of the property by the grantor was lacking in substance. The Court found that the dilution of the grantor's control seemed insignificant and immaterial, and that "since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position."

See also the recent case of Knetsch v. United States, 364 U. S. 361; Emanuel N. (Manny) Kolkey, 27 T. C. 37, 57-62, affd. (C.A. 7) 254 F. 2d 51; and the recent Fifth Circuit case of United States v. General Geophysical Co., supra.

I would have held that the Brown group made no valid "sale" to the Institute of their equity interests in the business.

Turner, Raum, Withey, Atkins and Mulroney, JJ., agree with this dissent.

Tax Court of the United States

Docket No. 83795

CLAY B. BROWN and DOROTHY E. BROWN,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liabilities filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there are deficiencies in income taxes due from the petitioners for the taxable years 1953 and 1954 in the amounts of $1,044.94 and $122.92, respectively; and

That there is an overpayment in income tax for the taxable year 1955 in the amount of $37.85, which amount was paid on April 12, 1956, and for which amount a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of mailing of the notice of deficiency.

/s/ IRENE F. SCOTT
Judge

* * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioners.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83796

DONALD L. BROWN and INGRID R. BROWN,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liability filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioners for the taxable year 1954 in the amount of $597.56;

That there is an overpayment in income tax for the taxable year 1955 in the amount of $21.20, which amount was paid March 28, 1956, and for which amount a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency; and

That there is an overpayment in income tax for the taxable year 1956 in the amount of $6.68, which amount was paid on April 15, 1957, and for which amount a claim for refund could have been filed, under the provisions of section 6511(b)(2) of the Internal

Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency.

/s/ IRENE F. SCOTT,
Judge.

* * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioners.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83797

CHARLES WILLIAM BOOTH and NANCY H. BOOTH,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liability filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, **it is**

Ordered and Decided: That there are deficiencies in income taxes due from the petitioners for the taxable years 1953 and 1955 in the amounts of $20.30 and $9.38, respectively;

That there is an overpayment in income tax for the taxable year 1954 in the amount of $5.60, which amount was paid on March 10, 1955 and for which amount a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency; and

That there is an overpayment in income tax for the taxable year 1956 in the amount of $1.41, which amount was paid April 15, 1957, and for which amount a claim for refund could have been filed, under the

provisions of section 6511(b)(2) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency.

/s/ IRENE F. SCOTT,
Judge.

* * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioners.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83798

DONALD LEE BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liability filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioner for the taxable year 1953 in the amount of $942.48.

/s/ IRENE F. SCOTT,
Judge.

* * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision

entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioner.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83799

PHILIP F. BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liability filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioner for the taxable year 1953 in the amount of $55.00;

That there is an overpayment in income tax for the taxable year 1954 in the amount of $1.19, which amount was paid April 15, 1955 and for which amount a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of mailing of the notice of deficiency;

That there is an overpayment in income tax for the taxable year 1955 in the amount of $22.34, which amount was paid: $11.23 on December 28, 1955 and $11.11 on April 15, 1956; and for which amounts a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code

of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency; and

That there is an overpayment in income tax for the taxable year 1956 in the amount of $6.67, which amount was paid April 15, 1957, and for which amount a claim for refund could have been filed, under the provisions of section 6511(b)(2) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency.

/s/ IRENE F. SCOTT,
Judge.

* * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioner.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83800

MARILYN BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the opinion of the Court filed December 19, 1961, and the agreed computation of the tax liability filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there is a deficiency in income tax due from the petitioner for the taxable year 1953 in the amount of $55.00;

That there is no deficiency in income tax due from, or overpayment due to, the petitioner for the taxable year 1954;

That there is an overpayment in income tax for the taxable year 1955 in the amount of $22.34, which amount was paid: $0.39 on December 28, 1955 and $21.95 on April 12, 1956; and for which amounts a claim for refund could have been filed, under the provisions of section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency; and

That there is an overpayment in income tax for the taxable year 1956 in the amount of $6.67, which amount

was paid December 28, 1956, and for which amount a claim for refund could have been filed, under the provisions of section 6511(b)(2) of the Internal Revenue Code of 1954, on July 30, 1959, the date of the mailing of the notice of deficiency.

/s/ IRENE F. SCOTT,
Judge

* * * * *

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

/s/ WILLIAM H. KINSEY,
Attorney for Petitioner.

/s/ CRANE C. HAUSER,
Chief Counsel,
Internal Revenue Service

/s/ WILLIAM H. KINSEY,
Attorney for Petitioner.

[Seal]

Entered April 3, 1962.

Served April 3, 1962.

Tax Court of the United States

Docket No. 83795

CLAY B. BROWN and DOROTHY E. BROWN,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 83796

DONALD L. BROWN and INGRID R. BROWN,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 83797

CHARLES WILLIAM BOOTH and NANCY H. BOOTH,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 83798

DONALD LEE BROWN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 83799

PHILIP F. BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 83800

MARILYN BROWN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above-named taxpayers by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance to the facts herein stipulated, or to object to the introduction in evidence of any such facts on the of immateriality or irrelevancy.

1. Petitioners, Clay B. Brown and Dorothy E. Brown, Docket 83795, are husband and wife residing in Portland, Oregon. During the calendar years 1953, 1954 and 1955 petitioners filed Federal individual joint income tax returns with the District Director of In-

ternal Revenue for the District of Oregon. Attached hereto, marked Exhibits 1-A, 2-B and 3-C, respectively, are photostatic copies of petitioners' income tax returns for the calendar years 1953, 1954 and 1955.

2. Petitioners, Donald L. Brown and Ingrid R. Brown, Docket 83796, are husband and wife now residing in Portland, Oregon. During the calendar years 1954, 1955 and 1956 petitioners filed Federal individual joint income tax returns with the District Director of Internal Revenue for the District of California at San Francisco. Attached hereto, marked Exhibits 4-D, titioners' income tax returns for the calendar years 1954, 5-E and 6-F, respectively, are photostatic copies of pe-1955 and 1956.

3. Petitioners, Charles William Booth and Nancy H. Booth, Docket 83797, are husband and wife residing in Milwaukie, Oregon. During the calendar years 1953, 1954, 1955 and 1956 petitioners filed Federal individual joint income tax returns with the District Director of Internal Revenue for the District of Oregon. Attached hereto, marked Exhibits 7-G, 8-H, 9-I and 10-J, respectively, are photostatic copies of petitioners' income tax returns for the calendar years 1953, 1954, 1955 and 1956.

4. Petitioner, Donald Lee Brown, Docket 83798, now resides in Portland, Oregon with the wife, Ingrid R. Brown. During the calendar year 1953 petitioner

filed his Federal individual income tax return with the District Director of Internal Revenue for the District of California at San Francisco. Attached hereto, marked Exhibit 11-K, is a photostatic copy of petitioner's income tax return for the calendar year 1953.

5. Petitioner, Philip F. Brown, Docket 83799, is an individual residing in Portland, Oregon. During the years 1953, 1954, 1955 and 1956 petitioner filed Federal individual income tax returns with the District Director of Internal Revenue for the District of Oregon. Attached hereto, marked Exhibits 12-L, 13-M, 14-N and 15-O, respectively, are photostatic copies of petitioner's income tax returns for the calendar years 1953, 1954, 1955 and 1956.

6. Petitioner, Marilyn Brown, Docket 83800, is an individual residing in Portland, Oregon. During the calendar years 1953, 1954, 1955 and 1956 petitioner filed Federal individual income tax returns with the District Director of Internal Revenue for the District of Oregon. Attached hereto, marked Exhibits 16-P, 17-Q, 18-R and 19-S, respectively, are photostatic copies of petitioner's income tax returns for the calendar years 1953, 1954, 1955 and 1956.

7. Notices of deficiencies (copies of which are attached to the petitions in these cases and made a part hereof by this reference) were mailed to the above-described petitioners on July 30, 1959. On said notices

respondent determined deficiencies in income tax for the taxable years as follows:

Docket No.	Calendar Year	Petitioner	Deficiency
83795	1953	Clay B. Brown, et ux.	$ 2,732.62
	1954		5,073.80
	1955		50,779.14
83796	1954	Donald L. Brown, et ux.	2,080.04
	1955		16,621.28
	1956		5,815.76
83797	1953	Charles W. Booth, et ux.	79.74
	1954		231.66
	1955		2,005.41
	1956		840.97
83798	1953	Donald L. Brown	1,445.28
83799	1953	Philip F. Brown	260.00
	1954		1,042.61
	1955		18,462.71
	1956		6,639.80
83800	1953	Marilyn Brown	260.00
	1954		1,003.39
	1955		18,465.66
	1956		6,590.81

8. Clay Brown & Company, at all times herein pertinent (until its dissolution as hereinafter related) was an Oregon corporation qualified to do business in California, having an authorized capital stock of 50,000 shares, par value $1.00 per share. References made in this stipulation to the "corporation" means Clay Brown & Company. The certificate evidencing the filing of the articles of incorporation issued by the Oregon Corporation Commissioner on September 28, 1946 is hereto attached as Exhibit 20-T. After its incorporation and prior to 1949 Clay Brown & Company was engaged in the forest production sales business at wholesale. In 1949 the corporation acquired millsite property at Fortuna, California and constructed thereon a gang mill and planing mill with substantially all new

equipment. The gang mill and planing mill were put into operation during February 1950. In the spring of 1951 the corporation completed an additional unit consisting of a circle sawmill which was converted into a band sawmill during the fall of 1951. Such installation was primarily new equipment except for the band headrig which was acquired used. The output of the gang sawmill, band sawmill and planing mill was sold through the sales and executive office of the corporation maintained in 1111 U. S. National Bank Building, Portland, Oregon. The corporation also maintained a sales office in San Francisco.

9. Clay Brown and Company, Inc. had authorized capital stock (par value one dollar per share) of fifty-thousand shares. Thirty-two thousand shares were issued and outstanding as follows:

Name	Acquired	Number of Shares	Cost	Clay Brown & Co. Official Title
Clay B. Brown*	9-30-46	6,000	$6,000.00	President
Dorothy E. Brown*	"	6,000	6,000.00	None
Donald L. Brown	"	6,000	6,000.00	Ass't. Vice Pres.
Philip F. Brown	"	6,000	6,000.00	None
Marilyn Brown	"	6,000	6,000.00	None
Charles W. Booth	12-50	1,000	7,993.00	Secretary-Treasurer
Nancy H. Booth	4-52	500	4,000.00	None
C. A. Hill**		500	**	Vice President

*Parents of Donald L., Philip F. and Marilyn Brown.
**C. A. Hill is not a party to these proceedings.

10. Attached hereto, marked Exhibits 21-U and 22-V, respectively, are photostatic copies of the Federal corporation income tax returns of Clay Brown and Company, Inc. for the fiscal year ended April 30, 1952 and the short period ended January 31, 1953.

11. In October or November 1952, William B. Boone of the Portland, Oregon office of Dean Witter & Co., investment counselors and brokers, met Clay Brown

and brought him together with Louis H. Seagrave who was then the Chairman of the board of directors of California Institute for Cancer Research. A copy of a letter dated November 28, 1952 from William B. Boone to Louis H. Seagrave is hereto attached and marked Ex. 23-W.

12. Attached hereto, marked Ex. 24-X, are copies of circulars received by Mr. Boone of Dean Witter & Co. from Mr. Seagrave.

13. Two letters dated December 17, 1952 from Seagrave to Clay Brown & Company are attached hereto marked Exs. 25-Y and 26-Z, respectively.

14. Copies of the replies to the letters identified in paragraph 13, above, being a letter dated December 22, 1952 and a letter dated December 23, 1952 to Louis H. Seagrave signed by C. W. Booth, are attached hereto and marked Exs. 27-AA and 28-BB, respectively. The letter dated December 22, 1952 (Ex. 27-AA) makes reference to a statement prepared by Peat, Marwick, Mitchell & Co. dated April 30, 1952, and the original of such Peat, Marwick, Mitchell & Co. statement is attached hereto and marked Ex. 29-CC. Atatched to Ex. 27-AA is the letter Seagrave to Booth dated January 7, 1953.

16. Attached hereto and marked Ex. 30-DD are the introduction pages, index and 16 recapitulation pages of the appraisement of Clay Brown & Company made by General Appraisal Company dated July 21, 1951.

17. Attached hereto, marked Ex. 31-EE, is the appraisement of Clay Brown & Company made by General Appraisal Company dated January 14, 1953 supplementing the appraisal of July 21, 1951.

18. Attached hereto, marked as Ex. 32-FF, is a document entitled "Purchase Agreement" and dated February 4, 1953.

19. The stock record book of Clay Brown and Company reflects issuance of the stock as hereinbefore set forth, the cancellation of such shares of stock as of February 4, 1953, the issuance of a certificate in the amount of 32,000 shares to the California Institute for Cancer Research, Certificate No. 18, dated February 4, 1953 which certificate bears the following typed legend:

> "Cancelled March 14, 1953 upon complete liquidation of the corporation pursuant to resolutions adopted by stockholders and directors on February 4, 1953."

and the endorsement dated March 13, 1953 of the California Institute for Cancer Research as follows: "Certificate being returned for cancellation".

20. The following exhibits relate to the "liquidation" of Clay Brown and Company referred to in the certificate mentioned in the preceding paragraph:

Minutes of special meeting of the Board of Directors of Clay Brown and Company held on February 4, 1953, the original of which minutes are hereto attached as Ex. 33-GG.

Minutes of special meeting of the stockholders of Clay Brown and Company held on February 4, 1953, the original of which minutes are hereto attached as Ex. 34-HH. Attached to Ex. 34-HH is a waiver of notice for stockholders, a proxy to Louis H. Seagrave and a certified copy of reso-

lutions of the California Institute for Cancer Research.

(Mr. Sabin and Mr. Simmons are or were attorneys in the office of Wilbur, Mautz, Souther & Spaulding, Portland, Oregon (now Mautz, Souther, Spaulding, Kinsey and Williamson).)

Minutes of special meeting of the Board of Directors of Clay Brown and Company held on February 4, 1953, the original of said minutes being hereto attached as Ex. 35-II.

Certificate and copies of resolutions dissolving the corporation executed on behalf of Clay Brown and Company and filed with the Oregon Corporation Commissioner are hereto attached as Ex. 36-JJ.

Grant deed dated February 4, 1953 from Clay Brown and Company to California Institute for Cancer Research, a copy of which is hereto attached as Ex. 37-KK.

Bill of sale dated February 4, 1953 from Clay Brown and Company to California Institute for Cancer Research, a copy of which is hereto attached as Ex. 38-LL.

General assignment dated February 4, 1953 from Clay Brown and Company to California Institute for Cancer Research, a copy of which is hereto attached as Ex. 39-MM.

Copy of title report of Belcher Abstract and Title Co. of Eureka, California, a copy of which is hereto attached as Ex. 40-NN.

U. S. Treasury Department Forms 1099-L and 966 filed by or on behalf of Clay Brown and

Company, copies of which forms are hereto attached as Exs. 41-OO and 42-PP.

A copy of the minutes of Clay Brown and Company immediately preceding the minutes of February 4, 1953 is hereto attached as Ex. 43-QQ. Prior to minutes of Clay Brown and Company dated February 4, 1953 the minute book of Clay Brown and Company contains no minutes relating to the transaction with the California Institute for Cancer Research.

21. The California Institute for Cancer Research issued a nonnegotiable, non-interest bearing promissory note in the amount of $1,300,000.00, dated February 4, 1953, payable to Clay Brown, et al. A copy of the note is attached hereto as Ex. 44-RR and said note is hereinafter referred to as the "promissory note". The promissory note referred to the following:

Deed of trust dated February 4, 1953, between the California Institute for Cancer Research as trustor, Belcher Abstract & Title Company as trustee, and Clay Brown, et al., as beneficiary, a copy of which deed of trust is hereto attached as Exhibit 45-SS.

Chattel mortgage dated February 4, 1953 from the California Institute for Cancer Research as mortgagor to Clay Brown, et al., as mortgagees, the executed original of which is hereto attached marked Ex. 46-TT.

A security document not referred to in the promissory note was a general assignment dated February 4, 1953 from the California Institute for Cancer Research to

Clay Brown, et al., the executed original of which is hereto attached marked Ex. 47-UU. As indicated in the letter dated March 12, 1953 from Belcher Abstract & Title Company to Wilbur, Mautz, Souther & Spaulding, the original of which is hereto attached marked Ex. 48-VV, the deed dated February 14, 1953 (Ex. 37-KK), the deed of trust dated February 4, 1953 (Ex. 45-SS), and the chattel mortgage dated February 4, 1953 (Ex. 46-TT) were recorded on March 12, 1953.

22. Fortuna Sawmills, Inc. is a California corporation incorporated on January 26, 1953 having authorized capital stock of 2500 shares, par value $10.00 per share. All of said shares were issued and outstanding, and were owned 2,000 shares by Calvin N. Souther and 500 shares by William H. Kinsey. The officers and directors of Fortuna Sawmills, Inc. were:

Calvin N. Souther	President and Director
Raymond P. Underwood*	Vice President and Director
William H. Kinsey	Secretary and Director

*Mr. Underwood is a member of the same legal firm as Mr. Souther and Mr. Kinsey, the present name of the firm being Mautz, Souther, Spaulding, Kinsey and Williamson.

23. Fortuna Sawmills, Inc. was a party to the following:

Lease and license agreement dated February 4, 1953 between the California Institute for Cancer Research as lessor, and Fortuna Sawmills, Inc. as lessee, the executed original of said lease being hereto attached as Ex. 49-WW.

General assignment dated February 4, 1953 from the California Institute for Cancer Research to

Fortuna Sawmills, Inc., a copy of which is hereto attached as Ex. 50-XX.

Assumption agreement of Fortuna Sawmills, Inc., dated February 4, 1953, a signed counterpart of which is hereto attached as Ex. 51-YY.

Promissory note of Fortuna Sawmills, Inc. dated May 15, 1953 in the amount of $20,999.79, a copy of which is hereto attached as Ex. 52-ZZ.

24. Attached hereto and marked Ex. 53-AAA are copies of all pages of Fortuna Sawmills, Inc.'s minute book except those indicating reelection of members of the board and officers.

25. The Clay Brown & Co. transaction is referred to in the following minutes of two meetings of the Board of Directors of California Institute for Cancer Research:

Minutes of the meeting of the Board of Directors held on January 6, 1953, a copy of these minutes being hereto attached marked Ex. 54-BBB, together with the documents referred to therein contained in the Institute minute book following the minutes of the meeting.

Minutes of the meeting of the Board of Directors held on January 27, 1953, a copy of these minutes being hereto attached marked Ex. 55-CCC, together with the documents referred to therein contained in the Institute minute book following the minutes of the meeting.

26. The assets of Clay Brown & Co. were subject to a mortgage to the United States National Bank of Portland, Oregon, in participation with the Reconstruction

Finance Corporation. The bank and the R. F. C. consented to the transfer of the property by Clay Brown & Co. upon its liquidation to the California Institute for Cancer Research. An executed copy of such consent and assumption agreement of Fortuna Sawmills, Inc., is hereto attached as Ex. 56-DDD.

27. Attached hereto marked Ex. 57-EEE is letter dated November 3, 1954, from William H. Kinsey to Clay Brown. A copy of this letter is included as an exhibit at the request of respondent, such copy having been taken by respondent from the records of the California Institute for Cancer Research subpoenaed by respondent. This letter of November 3, 1954, on page 2 quotes from an eleven page opinion of Wilbur, Mautz, Souther & Spaulding, attorneys. In response to the request of respondent, a copy of this memo, Ex. 58-FFF, has been supplied by said attorneys, said memo being one of the copies thereof in the files of said attorneys contained in a flat folder entitled "Preliminary Drafts and Related Matters". Attached hereto as exhibits are the following related correspondence and file:

Copy of letter dated November 5, 1954 from Clay Brown to Paul K. Yost, Executive Vice President of California Institute for Cancer Research, enclosing in duplicate the above-mentioned letter of November 3, 1954, a copy of which letter is hereto attached, marked Ex. 59-GGG.

Copy of letter dated November 30, 1954 from Clay Brown to Paul K. Yost, Executive Vice President of California Institute for Cancer Research, a copy of which is hereto attached marked Ex. 60-HHH.

Letter dated February 24, 1955 from William H. Kinsey to Arthur A. Armstrong making reference to the proposal contained in his letter of November 3, 1954 to Clay Brown, a copy of which letter is hereto attached marked Ex. 61-III.

Contents from flat folder entitled "Preliminary Drafts and Related Matters" in files of Wilbur, Mautz, Souther & Spaulding (now Mautz, Souther, Spaulding, Kinsey & Williamson) are attached hereto as Ex. 62-JJJ.

28. Attached hereto as Exs. 63-KKK and 64-LLL, respectively, are photostatic copies of the Federal corporation income tax returns of Fortuna Sawmills, Inc. for the short period February 1, 1953 to April 30, 1953 and the fiscal year ended April 30, 1954.

29. The Cancer Research Foundation of California was formed as a nonprofit, non-stock corporation on April 26, 1945, under the provisions of Division 1, Part 4, Title 12. Article 1 of the Civil Code for such scientific, charitable and educational purposes as are set forth in its Articles of Incorporation. On August 25, 1947, its name was changed to California Institute for Cancer Research. On February 25, 1957, the name was changed to West Los Angeles Institute for Cancer Research.

30. The sawmill and planing mill operations of Fortuna Sawmills, Inc. were shut down and discontinued on or about June 19, 1957, and the lease between the California Institute and Fortuna Sawmills, Inc., expired on January 31, 1958. Correspondence (three letters) relating to the shut down of the mill and the delivery

of possession upon termination of the lease is attached hereto, as Ex. 65-MMM, more particularly described as follows:

> Letter dated June 21, 1957 from Calvin N. Souther, President of Fortuna Sawmills, Inc. to Clay Brown.
>
> Letter dated July 9, 1957 from Clay Brown to George Castera, President of West Los Angeles Institute for Cancer Research.
>
> Letter dated December 6, 1957 from Calvin N. Souther, President of Fortuna Sawmills, Inc. to West Los Angeles Institute for Cancer Research.

Further correspondence is attached hereto, marked and described as follows:

> Letter dated January 10, 1958 from Clay Brown to Calvin N. Souther, President, Fortuna Sawmills, Inc., the original of which is hereto attached marked Ex. 66-NNN.
>
> Letter dated January 20, 1958 from Clay Brown to Calvin N. Souther, President of Fortuna Sawmills, Inc. and to William H. Kinsey, the original of which is hereto attached marked Ex. 67-OOO, together with copies of the following referred to therein:
>
> Letter dated January 17, 1958 from West Los Angeles Institute for Cancer Research to Clay Brown, individual representative of the sellers of the stock of Clay Brown & Co. and to Fortuna Sawmills, Inc.; Letter dated January 9, 1957, from George Castera to Clay Brown; Letter dated December 20, 1956, from Fortuna Sawmills,

Inc. to George Castera, President of California Institute of Cancer Research.

Letter dated January 29, 1958 from Fortuna Sawmills, Inc., signed by William H. Kinsey, to George Castera, President West Los Angeles Institute for Cancer Research, a copy of which is hereto attached marked Ex. 68-PPP.

Letter dated January 31, 1958 from Calvin N. Souther to Clay Brown, a copy of which is hereto attached marked Ex. 69-QQQ.

Letter dated February 1, 1958 from Clay Brown to Calvin N. Souther, a copy of which is hereto attached marked Ex. 70-RRR.

Letter dated February 14, 1958 from Calvin N. Souther, President of Fortuna Sawmills, Inc. to Clay Brown, a copy of which is hereto attached and marked Ex. 71-SSS.

Letter dated February 14, 1958 from Calvin N. Souther, President of Fortuna Sawmills, Inc. to West Los Angeles Institute for Cancer Research, a copy of which is hereto attached and marked Ex. 72-TTT.

31. A schedule is attached to this stipulation summarizing the net profit or loss made by Fortuna Sawmills, Inc. during its operations, the payments made by Fortuna Sawmills, Inc. to California Institute for Cancer Research under the Lease and License Agreement, and payments made by the California Institute for Cancer Research for application upon the promissory note. The schedule is marked Ex. 73-UUU.

32. A copy of an agreement, dated June 3, 1958, as of February 1, 1958, by and between West Los Angeles

Institute for Cancer Research, formerly California Institute for Cancer Research, and Clay Brown, Dorothy E. Brown, Donald Brown, Philip Brown, Marilyn Brown, C. A. Hill, Nancy H. Booth and C. W. Booth, is attached hereto as Ex. 74-VVV.

33. In July 1959, the property subject to the deed of trust and chattel mortgage was acquired by the Division of Highways, State of California, for $300,000.00 as a result of threatened condemnation proceedings. Such acquisition and the distribution of proceeds therefrom, is reflected in the following:

Escrow instructions to Belcher Abstract & Title Company dated May 15, 1959, a copy of which are hereto attached as Exhibit 75-WWW.

Letter dated June 18, 1959 from Belcher Abstract & Title Company requesting that the original note and deed of trust be surrendered to Belcher Abstract & Title Company for cancellation, the original of which is hereto attached as Ex. 76-XXX.

Letter dated June 19, 1959 from C. W. Booth to Belcher Abstract & Title Company enclosing the original deed of trust and promissory note, a copy of which is hereto attached as Ex. 77-YYY.

Satisfaction of chattel mortgage showing the recording thereof, the original of which is hereto attached as Ex. 78-ZZZ.

Letter dated July 7, 1959 from Belcher Abstract & Title Company, enclosing check for $8,765.48 to Clay Brown & Company, and a check for $262,096.49 to Clay Brown and statement showing disbursement of funds, marked Ex. 79-AAAA.

Statement dated July 7, 1959 of Belcher Abstract & Title Company to West Los Angeles Institute for Cancer Research showing disposition of the $300,000 received from the Division of Highways, State of California, attached as Ex. 80-BBBB.

Statement of Clay Brown & Company to West Los Angeles Institute for Cancer Research substantiating the $8,765.48.

34. The promissory note was surrendered to Belcher Abstract & Title Company and cancelled in connection with the acquisition of the property by the Division of Highways, State of California.

35. May 1, 1952 letter from H. E. Reardon setting $9 per M stumpage value on timber, the original of which is hereto attached as Ex. 81-CCCC.

36. Peat, Marwick, Mitchell & Co. audit of January 31, 1953, hereto attached as Ex. 82-DDDD.

37. Photostatic copies of documents, clippings and correspondence from the files of the West Los Angeles Institute for Cancer Research (formerly California In-

stitute for Cancer Research) are attached hereto, described and marked as exhibits as follows:

Item	Date	Exhibit No.
Letter	February 26, 1953	83-EEEE
2 letters	January 7, 1953	84-FFFF
List	January 22, 1953	85-GGGG
Letter	January 26, 1953	86-HHHH
Letter	February 21, 1953	87-IIII
Letter	March 31, 1953	88-JJJJ
Letter	April 20, 1953	89-KKKK
Letter	May 1, 1953	90-LLLL
Letter	May 6, 1953	91-MMMM
Letter	January 12, 1954	92-NNNN
Letter	June 22, 1954	93-OOOO
Letter	November 5, 1954	94-PPPP
Letter	November 24, 1954	95-QQQQ
Letter	November 30, 1954	96-RRRR
Schedule	April 30, 1955	97-SSSS
Letter	August 9, 1955	98-TTTT
Letter	November 23, 1955	99-UUUU
Clipping	December 23, 1955	100-VVVV
Letter	March 13, 1956	101-WWWW
Letter	December 12, 1957	102-XXXX
Letter	January 30, 1958	103-YYYY
Minutes	Various, 1958	104-ZZZZ

38. Insofar as this stipulation of facts utilizes joint exhibits numbers as well as certain descriptive titles

of the various documents, instruments and correspondence attached and referred to herein as pertaining to or underlying the transaction here involved, such utilization has been for the convenience of the parties and respondent in nowise concedes the true nature of substance of the transaction in issue is governed thereby.

39. In the interest of complying with rules of the Court, the parties hereto have stipulated all documentary evidence deemed necessary to the record herein. Accordingly, the parties hereby agree that the right of cross-examination of witnesses shall not be limited by the scope of direct examination into the facts of the transaction, rather each party may extend his cross-examination to the witnesses' knowledge of the transaction here involved.

/s/ WILLIAM H. KINSEY
Counsel for Petitioners

/s/ R. P. HERTZOG
Acting Chief Counsel
Internal Revenue Service

Filed Jan. 25, 1961.

In the United States Court of Appeals
For the Ninth Circuit

T. C. Docket No. 83795

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

v.

CLAY B. BROWN and DOROTHY E. BROWN,
Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

Comes now the Commissioner of Internal Revenue, by and through his undersigned counsel, and petitions this Honorable Court to review the decision of the Tax Court of the United States entered herein on April 3, 1962, pursuant to its opinion filed December 19, 1961 (37 T. C.—No. 50) in the consolidated proceedings of the respondents on review and five related taxpayers (in respect of whom separate petitions for review are being simultaneously filed herein), ordering and deciding "That there are deficiencies in income taxes due from the petitioners for the taxable years 1953 and 1954 in the amounts of $1,044.94 and $122.92, respectively; and that there is an overpayment in income tax for the taxable year 1955 in the amount of $37.85, which amount was paid on April 12, 1956, and for which amount a claim for refund could have been filed, under the provisions of Section 6511(c) of the Internal Revenue Code of 1954, on July 30, 1959, the date of mailing of the notice of deficiency."

Jurisdiction and Venue

This petition for review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954 and applicable amendments thereto.

The respondents on review, Clay B. Brown and Dorothy E. Brown, were husband and wife, residing in Portland, Oregon, during the years involved herein, and filed joint federal income tax returns for the years 1953, 1954 and 1955 with the District Director of Internal Revenue for the district of Oregon, whose office is located at Portland, within the jurisdiction and venue of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The principal issue presented for review is: Where pursuant to a prearranged plan, the respondents on review and others transferred their stock in a corporation engaged in the sale of forest products together with two promissory notes totaling $125,000 to an exempt institution for a so-called non-interest note secured by a mortgage and the latter leased the assets of the corporation to a new corporation organized by respondent's lawyers for a period of five years, and it was agreed to pay the principal of the note out of the rents received from the new corporation and the respondent-husband was employed by the new corporation to manage it and to lend their credit to it, did the Tax Court properly hold that the transaction constituted a bona fide sale of the stock, a capital asset, to the institution in return for its note and the gain realized

is taxable as a long-term capital gain within the meaning of Sections 117(a) and 1222(3) of the Internal Revenue Codes of 1939 and 1954, respectively.

In the alternate, if the gain is taxable as long-term capital gain, is any portion of the amounts received by the respondents on review in each of the years involved in payment of interest and taxable to them as "interest" income under Sections 22(a) and 61(a) of the Internal Revenue Codes of 1939 and 1954, respectively.

The majority of the Tax Court concluded that the agreement entered into between all the members of the so-called "Brown Group" and the institute on February 4, 1953, constituted a bona fide sale of their stock in Clay Brown & Company to the institute for a price arrived at in an arms-length transaction and that the amounts received from the institute are proceeds from the sale of their stock; that the note given for the stock was without interest until maturity and that arriving at the sales price of the stock no consideration was given by the parties in their negotiations to an amount in lieu of interest.

Six judges dissented from the majority opinion of the Tax Court and considered the intricate series of transactions here involved was a mere tax avoidance plan without substance or reality resulting in no valid sale of the stock or that the "Brown Group" received its share of the profits solely in the capacity of "creditors" of the institute.

What happened in the present case was summarized in a dissenting opinion of Judge Pierce on pages 33

34 and 35 of a slip opinion filed herein. Succinctly, the transaction in this proceeding involves the now familiar "bail-out sale" of capital stock in a going business to a valid tax exempt cancer research institution, (hereinafter described as "institute"), the "purchase price payments" (90% of profits) to be paid by a newly incorporated feeder company from future earnings as "rent" for operating assets (80% of profits before depreciation and taxes), which "rent" is siphoned through the institute to taxpayers. The feeder company retains 20% of the profits for its participation and the institute received 10% of the "rental payment". The taxpayers retain administrative control of the business through management contracts and power to appoint successor executives. The taxpayers' attorneys purchased the capital stock of the new feeder company and all operating assets are burdened with security devices in taxpayers' favor. The institute assumes no risks whatsoever. The avowed object of the plan is to "bail-out" retained earnings and future profits at capital gain rather than ordinary income tax rates. In the instant case, the institute's resources were committed to cancer research, not acquisition of a lumber-milling business in which it had no personnel to manage. It acted as a mere conduit, for which service it received what may properly be termed a fee.

It is submitted that a review of the transactions involved herein, in the light of their realities, when consideration is given to the person who had command and control over the business, who bore the risks of its operation and who was entitled to enjoy the substantial benefits therefrom, will reveal that the business was

not actually "sold" to a nontaxable institute and that there is not sufficient evidence of record to sustain the holdings of the majority opinion, and accordingly such holdings and conclusions of the majority should be reversed and the Commissioner's position taken herein should be upheld; to wit — that the purported purchase price payments are not entitled to capital gain treatment as a matter of law due to taxpayers' retention of economic interest in and control over the property. Viewing the record as a whole, the majority's ultimate finding with respect to the substance of the transaction is clearly erroneous.

It is also presented that the majority erred in finding that the transactions here were "arms-length" and "bona-fide". The essential nature of the transaction in the instant case was not an installment sale of the stock to the institute, but a joint venture by the taxpayers (Brown), the institute and the lawyer-organized new corporation (Fortuna) to share the earnings of the lumber business for the mutual benefit of all, and therefore the Tax Court erred in holding that the substance of the transactions was a bona-fide sale of the stock resulting in a long-term capital gain.

It is, therefore, presented that the views set forth in the dissenting opinions are correct and should be followed by this Honorable Court on review.

The Commissioner further presents in the alternate that upon the record here, the parties to the transaction intended the sum of $237,112 of the note given to be "interest". The Tax Court's finding that the record does not support this conclusion is clearly erroneous.

Statement of Points

The statement of points to be relied upon will be filed at a later date as provided by the Rules of this Court.

Wherefore, it is prayed that the errors complained of herein be reviewed and corrected and that the decision of the Tax Court be reversed.

/s/ LOUIS F. OBERDORFER,
Assistant Attorney General

/s/ CRANE C. HAUSER
Chief Counsel
Internal Revenue Service,
Counsel for the Commissioner of
Internal Revenue.

[Representative of all Petitions for Review.]

Filed June 25, 1962 (USTC).

Tax Court of the United States
Washington

Docket Nos. 83795, 83796, 83797, 83798, 83799, 83800.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CLAY B. BROWN and DOROTHY E. BROWN, DONALD L. BROWN and INGRID R. BROWN, CHARLES WILLIAM BOOTH and NANCY H. BOOTH, DONALD LEE BROWN, PHILIP F. BROWN, MARILYN BROWN,
Respondents.

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the documents submitted under this certificate, 1 to 53, inclusive, as called for by the designation, and the rules, are the original documents of record on file in my office, excepting the original exhibits which are separately certified, and a true copy of the docket entries as they appear in the official docket of my office, in the cases docketed at the above numbers, in which the respondent in this Court filed petitions for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 10th day of September, 1962.

[Seal]

/s/ HOWARD P. LOCKE,
Clerk of the Court.

121 BEFORE THE TAX COURT OF THE UNITED STATES

Dockets Nos. 83795 through 83800

CLAY B. BROWN AND DOROTHY E. BROWN, et al., *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Transcript of Hearing—January 25, 1961

U. S. Court of Appeals
U. S. Courthouse (New)
Portland, Oregon

(Met, pursuant to notice, at 2:00 o'clock p.m.)

BEFORE:

Hon. IRENE SCOTT, Judge.

Appearances:

WILLIAM H. KINSEY, Esq. and JAMES R. MOORE, Esq. Board of Trade Building, Portland, Oregon; appearing for Petitioners.

NORMAN H. MCNEIL, Esq. and AARON S. RESNICK, Esq. 484 Pittock Block, Portland, Oregon; appearing for Respondent.

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122 WILLIAM B. BOONE was called as a witness by and on behalf of Petitioners and, having been first duly sworn, testified as follows:

The Clerk: For the record, may we have your name and address?

The Witness: William B. Boone.

The Clerk: How do you spell your last name?

The Witness: B-double o-n-e.

The Clerk: And your home address?

The Witness: 2432 S. W. Broadway Drive, Portland, Oregon.

Direct Examination

By Mr. Kinsey:

Q. What is your occupation, Mr. Boone? A. I am the resident partner and manager of Dean Witter & Company.

Q. And what is the business—(interrupted) A. We are in the investment business. Members, New York Stock Exchange and general investment bankers.

Q. In 1952, did you have any contact with Mr. Clay
123 Brown? A. I did.

Q. Would you explain the nature and circumstances of that contact? A. In the summer of 1952, Mr. George Vanderhoff (phonetic), one of my partners in our Beverly Hills office was here visiting. He stated to me that Mr. Guy Witter, in our Los Angeles office was in touch with a source of funds that was interested in acquiring and buying small companies. Subsequent to that, having inquired of a number of people, and I have known Clay Brown for a good number of years—about fifteen years—I was in contact with Clay and I stated to him, would he have any possible interest in selling his company; and in turn, he stated that not particularly. He wasn't anxious to sell it and what did I have in mind. Well, I said, "I don't know, there is some possibility—would it come about?" I notice in going through my file that on August the 8th of 1952, I wrote a letter to Mr. Guy Witter, of my Los Angeles office, and stipulating that in general on a confidential basis, there may be some possibility of Clay Brown & Company being acquired.

Mr. Resnick: Do you have that letter, Mr. Boone?

The Witness: Yes, I do.

(Letter produced and handed)

A. Following the first letter that the attorney had just taken, Mr. Guy Witter responded and stated to the fact that the parties that he was—thought might be inter-
124 ested were not interested and subsequent to that time, he did come back again and say that the Cancer Research of Los Angeles, he felt would be interested in acquiring Clay Brown & Company. At that time, Mr. Seagrave, who represented the Cancer Institute came to Portland one day, and I contacted the Clay Brown & Company office and found that Mr. Brown was not in town; made arrangement at a later time, which I have detailed wires in here expediting the meeting of Mr. Seagrave and Mr. Clay Brown in Eureka, California. And that was the time when the begining negotiations started.

Q. Did you participate in the negotiations? A. Only to the degree that—of fitting in round numbers, not the actual negotiations, in the original part. I certainly did participate in the final negotiations when Mr. Seagrave came back and I spent all day with Mr. Seagrave, Mr. Brown, Mr. Booth and I believe Mr. Souther in trying to come to a final conclusion, but as far as the preliminary facts are concerned, I did not.

Q. In your participation in the negotiations, were you aware of any negotiation relative to price? A. Well, obviously there was quite a little negotiation on this matter of fact what the price—what the offering of the stock was, what the price was on that scale.

Q. Was the main subject in the negotiations
125 price? A. I think there was definitely a consideration of price in negotiations in the begining. I mean, if there hadn't been a certain price that had been gained, I am certain that Mr. Brown would not have been interested in selling it.

Q. But the actual agreement on the price and the finalization in the negotiations was handled directly by Mr. Seagrave and Mr. Brown after you introduced them, is that correct? A. There were negotiations carried on consistently which I was not in presence. As far as their figure that finally in the final conclusion they came down and had a substantial spread, as I remember, of about a hundred and fifty thousand dollars difference between what Mr. Seagrave felt this company was worth and Mr. Brown—what Mr. Brown—it was two hundred thousand. I remember it roughly. You have all the facts there. It seems to me it was a million three and a million five. As far as getting together and making any conclusions—as a matter of fact, I was confident that one time, the whole situation had been completely dissolved, that we were not going to be able to conclude the deal.

Mr. Resnick: I move that the last remark be stricken as not responsive to the question and merely an observation, not a statement of fact.

The Court: The motion is denied.

Mr. Kinsey: That's all I have of this witness.

Cross Examination

126 By Mr. Resnick:

Q. Mr. Boone, do you have your files? A. Yes, I have.

Q. May I see them? A. You certainly may. These are the same ones you saw yesterday.

(Documents produced)

Q. At the time that you met with Mr. Seagrave of the Cancer Institute, he left with you, certain brochures and information with reference to the sale or transactions involving disposition of businesses to the Institute? A. Yes, he did. I think you took those out of the file yesterday, sir.

Q. Did you discuss the substance of those documents with Mr. Brown? A. At that point, I probably—I must have.

Mr. Resnick: The brochures we refer to, your Honor, are part of the stipulation Exhibit 24-X.

Q. Did you write a note to Mr. Brown and forward copies of some of those schedules to him for his review and consideration? A. Well, I think there is one letter there that you have—what schedule are you referring to? I'm not—(interrupted)

Q. The schedules I refer to are the various docu-
127 ments and statements that Mr. Seagrave left with you? A. Well, I am confident that I discussed them with Mr. Brown but I am not certain that Mr. Seagrave didn't see Mr. Brown before I did. In other words, at the time it was wired there making arrangements for Mr. Seagrave to meet Mr. Brown in Eureka, the one right below you there, sir, where there's various wires about making plane schedules and reservations and what not. Those were the wires that I was making to our Los Angeles office over our wire system and I just don't remember. I can't say completely, but I am certain I must have discussed it with him.

Q. At the time that you met with Mr. Seagrave and arranged for meetings between him and Mr. Brown, were you aware of the fact that Mr. Seagrave was representing the Cancer Institute, that it was a tax exempt organization? A. Absolutely; I certainly was.

Q. And you so conveyed that information to Mr. Brown? A. That's exactly right. The Cancer Institute

had a fine recommendation from my associates in Los Angeles—Beverly Hills, as being very outstanding people.

Mr. Resnick: I have no further questions of the witness at this time.

The Court: Do you have anything further, Mr. Kinsey?

Redirect Examination

By Mr. Kinsey:

128 Q. Mr. Boone, did you receive a fee for your participation? A. Yes, I did.

Q. What was the amount of your fee? A. One percent.

Q. And was there a written fee agreement? A. Yes.

* * * * * * * * * *

CLAY BROWN one of Petitioners herein, was called as a witness on his own behalf and, having first been duly sworn, testified as follows:

* * * * * * * * * *

129 Direct Examination

By Mr. Kinsey:

Q. Mr. Brown, you are a Petitioner in these proceedings, is that correct? A. I didn't hear you.

Q. You are a Petitioner in these proceedings? A. Right.

Q. And Clay Brown & Company was named after you or bears your name, is that correct? A. That is correct.

Q. It is stipulated that the corporation Clay Brown & Company was formed in 1946. Would you just tell the Court something about its operations leading up to your contact with Mr. Seagrave? A. Well, briefly, we built a sawmill in Fortuna, California—a Swedish gang mill. It was the first of its type in the State of California, used in production of fir logs into lumber. We commenced operation in 1950—January, or the first part of February, somewhere in that area, and then we added on to the operations as we went along. That was a thirty-six-inch Swedish gang mill and later we added a nine-foot band mill. As I stated, it was the first one in that portion of the country. We were received down there by the people very gratefully, particularly the ranchers. I had operated

130 in that Humboldt County, at which this mill was located with a plywood—fir plywood plant, the first

of its type in the State of California—integrated plant—became familiar with the timber in that area. I had been in the sawmill business practically all of my adult life and had conceived the idea that a gang mill would be ideal for that type of timber in that area. Shortly after we went into production with the gang mill and before the band mill was constructed and put into operation, the local citizenry down there gave a dinner party to the key men in our organization, and they were happy to see us come in—as I say, the ranchers were too, because there were a lot of bare spots in the timber areas down there that was ideal for ranching—cattle grazing—primarily cattle country. The timber was small, it lent itself to that type of an operation: The Chairman of the County Commission, a Mr. McLeod (phonetic), at that particular time, in a statement made before the group at this particular dinner—I think I said lunch a moment ago, but it was a dinner—stated that it would be a good thing for the County, because prior to that time, except in a few isolated locations, the small trees were ringed so they would die and they would go under the ground and they would be burned and the land would be thrown into grazing lands. By our coming in there, we were able to take that type of timber and convert it into merchantable lumber items, used
131 primarily in construction—boards and dimension as we use the term in our industry. Now, as we progressed—(interrupted)

Mr. Resnick: May I interrupt you for a moment? would you tell us what a gang mill is? A. Well, there are two types of gang mills, but this is what is known as a log gang mill. There is also a sash gang mill, but that's a different type. This is a Swedish gang mill—the name derives from Sweden, first built there and licensed to be made—to produce in this country.

Q. Maybe what counsel means, Mr. Brown, is the difference between a gang mill and a band saw mill. A. Well, a gang mill is a sash mill—a series of vertical knives and you pass the log through the knives, the sash moving up and down and the log in its entirety goes right through. From there, it goes in—from the process from behind the gang mill, the lumber is manufactured through the typical way through edgers and trimmers and planing mill and so

forth. The band mill is a single cut mill and the word band means that. The mill we had there was a nine-foot band mill.

Q. As I understand it, the gang mill was in operation around 1950, while the company was formed in 1946. What was the type of business during that—(interrupted) A. General wholesale lumber business.

Q. You heard Mr. Boone testify about his putting
132 you into contact with Mr. Seagrave. Would you start at that point and then recount what transpired thereafter? A. I first met Mr. Seagrave in Eureka, California, as Mr. Boone had stated. Mr. Boone had asked me at one time if we'd be willing to sell our operations. Our earnings were good. It was a family held organization. Over ninety percent of the stock of the corporation—one class of stock, was owned by myself and my family. I told him that if the price was right, I'd sell. We weren't looking for a sale or for a buyer and well, he said, "We may come up with something. We're in that business, securities business, trying to find the different operations or any sales that might be worthwhile to their clients." Well, that was the last I heard of it for some time. One day, I was in Fortuna where the mill is located—twenty miles south of Eureka on the California coast, and I had a call from Mr. Booth in my office, an associate of mine. He told me he had a gentleman in Portland; he'd talked with him, Mr. Seagrave in company with Mr. Boone and they were interested in the plant—at least taking a look at it. Subsequently, a meeting was arranged and I met Mr. Seagrave. He came to Eureka; I met him at the Eureka airport, took him out to the mill, took him over the area in general to see the type of timber that grew in that region. He was down there probably a day and a half or two days and then returned to Los Angeles. Following that,

I received—well, I think at that particular time
133 probably Mr. Seagrave outlined to me about how the Institute could operate and pay off on anything of this nature which they may acquire. I didn't give him an answer. I wanted to come back to Portland and talk to our directors and to our stockholders; first, to determine whether we wanted to sell, secondly, if we wanted to sell, what kind of a price we wanted for it. When we

finally made up our minds, if we could get a certain price, we would sell and I gave Mr. Boone the figures that we thought we should have, which was in the round figures of a hundred—a million five hundred thousand dollars, which included a note of a hundred and twenty-five thousand dollars payable to Mrs. Brown and myself in equal rights, which we had loaned to the Clay Brown Incorporation to build this mill plus a seventy-five thousand dollar loan from the RFC. From that point on, Mr. Seagrave came to Portland and we negotiated for several days and eventually we came up with a figure of a million three hundred thousand dollars, which included the note, which would bring the purchase price down to a million one seventy-five; but the note was an obligation. They were buying the capital stock of the corporation. Shortly thereafter, I guess it was the latter part of January, early February '53, the deal was consummated.

Q. What's your recollection as to how Fortuna Sawmills was selected or came into being? A. In the purchase
134 agreement, the Institute wanted someone to operate the plant. I think I first asked if they had know-how or if they knew of know-how and they told me no. They liked the organization we had and said they would like for the current operators to carry on the operation for an operating company if it could be formed. Well, I told them that I was just as interested as they were for the benefit of our stockholders, whether we operated it or not—that is, the old management. We were going to take a close look at who did because we wanted to make sure that our money—as sure as we could that our money would be paid in the sale. They couldn't come up with anyone—couldn't even suggest anyone and so in the presence of Mr. Souther, who had been my attorney on the Humboldt Plywood Plant in Humboldt County and who was familiar with that area in general, who represented me ever since our business—ever since I went into business for myself, which actually was in January—or July 1st, 1955, I said, "Would you be willing to form a company and I will operate the plant with the authority—with the permission from the Institute." The Institute was exploited and they insisted in the agreement that a management contract be drawn, which was a part of the instrument. That's how as I recall the Fortuna Sawmills came into the picture.

The Court: Excuse me, Mr. Brown. You said something about 1955?

A. 1945.

135 Q. At the time of the formation of Fortuna, were there discussions about whether you could or could not own a minority interest in Fortuna Sawmills?

Mr. Resnick: Discussions with whom?

Mr. Kinsey: Well, if you want to ask my next question for me, go ahead.

Q. With whom did you have any discussions and with whom did you have discussions as to whether you could or could not own a minority interest in Fortuna Sawmills? A. It was pointed out to me by Mr. Seagrave at one time that former stockholders of a corporation such as the Clay Brown & Company could own up to forty-nine percent of the operating company. And that came up in our negotations on the price. Well, I didn't look upon that with any favor at all, because number one, I do not care to invest money in an operation where I do not control it, but I did explore the possibility. I then went to my attorneys, Mr. Souther and yourself and showed them a letter of Mr. Seagrave, that outlined how this could be accomplished if we wanted to take advantage of it. They came back with the reply to me that they didn't altogether concur in that. Well, having a weak feeling toward having a minority interest anyway, it was dropped at that moment.

Q. Does Mr. Souther—did he or does he hold the Fortuna Plywood stock interest of his as nominee for you?

136 A. Yes.

Q. Is your nominee—by nominee, I mean, is he holding it for you? Do you have any interest in the Fortuna —(interrupted) A. Oh, no; no stock whatsoever.

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Q. Now, on the operations of Fortuna, what was your position with Fortuna Sawmills? A. I was engaged as General Manager.

Q. Would you then recount its operations during the ensuing years after February 4, 1953? A. You want

137 me to answer that in regard to the operation profitwise? If so, we have records here. I wouldn't attempt to relate them from memory.

Q. Well, you continued as general manager how long? A. I resigned as general manager in 1954 to take the presidency of M&M Woodworking Company of Portland.

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138 Q. After you went with M&M, who ran Fortuna operation-wise? A. Clarence Hill (phonetic) operated the sawmill; C. W. Booth more or less took over the general managership of it, who had headquarters here in our offices, which was the headquarters for Clay Brown & Company and was also the headquarters for Fortuna Sawmills.

139 Q. How long did the mills continue to operate? A. I recommended that that mill—the market went off rather sharply and substantial losses were being incurred, not only in the Fortuna Sawmills operation but other operations in similar position. If I remember rightly, I recommended in 1957, in a letter to Mr. Souther, President of Fortuna Sawmills that I thought the plant should be shut down after certain commitments—order files and so forth had been taken care of, and pointed out the reasons therefor and he agreed, and the plant was shut down. I can't give the exact month, I don't recall, but I am quite sure it was 1957.

Q. Did it resume operations again prior to the end of the five-year lease with the Institute? A. No.

Q. What happened around the expiration of the lease with the Institute? A. At the expiration of the five-year period?

Q. Yes. A. We felt, and when I say we, I am speaking for the former stockholders—that the Institute was in default of their contract, for lack of payment for the period within five years. I had a meeting in Los Angeles—or in Beverly Hills, with Mr. Castera, his legal representative, and Mr. Kinsey, yourself, and we found they were not in default. The time element had elapsed, yes, but there

140 was some ninety thousand dollars claimed by the Institute that was forgiven during a certain period of time—within a year's time, but not—that hadn't been paid. They took the stand—it was at my suggestion initially that we make these payments semi-annually to the Institute. The contract was written in that form but the plus or minus would be picked up after an audit. The

Institute took the position that if we had earnings in the first six months of the fiscal year, and which we did in this particular instanee, and losses in the last, and we paid the first six months on whatever the income was, that we could not apply it against the end of the fiscal year when the final audit was taken. That was their contention. That represented, as I recall, some ninety thousand dollars. So at that time, a supplemental agreement was drawn, which forgave Fortuna Sawmills the obligation of the ninety thousand dollars to the Institute; that the Institute through its efforts—best efforts, would attempt to sell the properties, or get someone else to operate the properties. And it went on for about a year; approximately a year. In the meantime, the Institute had been informed that the State Highway Commission was realigning a road, putting in a freeway and the freeway would go through the log pond, which was a seventeen-acre pond, the spur track would serve the mill and the planing mill—sawmills and the planing mill, would be deleted, and I—they talked to me about it, and I said, "It would be an island mill. We
141 don't want to have anything—I don't think you want to have anything like that on your hands." So from that point on, the Institute then began negotiations with the Institute—or the State Highway and the Institute, and I was kept informed, for the benefit of the former stockholders of Clay Brown & Company and they attempted, so I was told, to get about four hundred thousand dollars for the properties. They wanted to take just a portion of it, and I understood they was to sell—buy it all or none, as far as the Institute was concerned. So the final settlement was made and they bought all the properties.

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142 Cross Examination

By Mr. McNeil:

Q. Mr. Brown, was there any change in the management at the Fortuna location before and after the sale, or the transaction that we are discussing here? A. A change in the management?

Q. Was there any change in the management? Before and after the sale? A. No.

Were there any employees or excutives from the Institute—Cancer Institute—at the mill or employed at the mill? A. I'm sorry, I am a little hard of hearing. I can't hear you.

143 Q. Were there any employees or executives from the Institute—Cancer Institute—employed at the Fortuna location? A. No, not to my knowledge.

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144 Q. You have always maintained one office in this town, Mr. Brown? A. Since I have been in business for myself since 1945.

Q. This office is at 1111 U. S. National Bank Building?. A. Correct.

Q. The books and accounts of the present Clay Brown Company, Fortuna Sawmills operation, have always been maintained in Portland, in your offices, is that true? A. Clay Brown & Company's books are maintained in Portland and during the time of the operation of the Fortuna Sawmills, the records were kept in Portland.

Q. Now, do I understand, Mr. Brown, that the books and records of Fortuna Sawmills, Inc. were in your office here in Portland? A. That's correct.

145 Q. I believe you stated that after the mill became dormant or shut down, beginning some time in '57 or thereafter, that it was not thereafter leased to anybody —not operated? A. No, I didn't say that. I said that it was not operated again by Fortuna Sawmills.

Q. It was not operated again by Fortuna Sawmills. There was a lease in that period to another operator then? A. After the five-year period, there was a lease made between the Institute and an individual to operate the plant and operate it a few months with further losses and it was shut down. The lease was cancelled.

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146 Continued Cross Examination

Q. (By Mr. McNeil) Mr. Brown, who was the resident manager of Fortuna Sawmills? A. Clarence A. Hill.

Q. Now, he was resident manager before and after this transaction? A. Yes.

Q. After your resignation, did the personnel at Fortuna change? A. I didn't quite get that?

Q. After your resignation as manager, did the personnel otherwise change at Fortuna Sawmills? A. No.

147 Q. Did you visit the mill before the Institute deal was consummated? Did you go down there quite often? A. Oh, yes; I was down there quite frequently.

Q. Now—(interrupted) A. I happened to have properties down there in the same county.

Q. Did you continue these visits after the Institute transaction? A. You mean after the Institute had acquired the properties?

Q. Yes, did you look in at the mill whenever you were in Fortuna? A. Yes.

Q. And these would be frequent visits? A. Periodically.

Q. By periodically, once a month? A. Maybe once a month, maybe six weeks.

Q. Did any of your other companies sell Fortuna products? A. Yes, they did. The last year or so before we shut down, the Clay Brown & Company undertook the sale of the production. Up to that time, the sale had been handled by A. L. Hoover (phonetic) and Company in Los Angeles.

148 We were paying them three percent. Fortuna Sawmills was carrying the account. In the meantime, Mr. Hill had moved to southern California from the sawmill. My oldest son was at the sawmill, who has been identified in the business ever since he has been out of school.

Q. And what date is this? What date? A. This was prior to the shutdown, possibly a year before the shutdown of the plant.

Q. 1957? A. I think prior to that, yes.

Q. This would be generally 1957? A. So then, they suggested that to relieve the credit responsibility with the funds for part of the operating capital, that the Clay Brown should take it over on a three percent basis and assume all credit risks, which they did.

Q. Do I understand, Mr. Brown, that after your resignation as general manager of Fortuna Sawmills that you continued your periodic visits? A. That's right.

Q. Going back to the time of the transaction—this would be January or thereabouts 1953. Were you interested in

—personally interested in who purchased the stock in Fortuna Sawmills, Inc? Did you care who purchased the stock? A. The plant wasn't for sale. You are talking about the sawmill or are you talking about the operating company?

149 Q. I am talking about the creation of Fortuna Sawmills, Inc., and the capital stock of Fortuna (interrupted) A. Did I care who would purchase —(interrupted)

Q. Did you care who would—(interrupted) A. —who would be the operating company?

Q. Who owned the stock—did you care? A. Of the operating company?

Q. Yes. A. No, I didn't care, as long as I was satisfied that—representing the former stockholders, that adequate and proper management would be in there.

Q. In other words, you were interested in management and not ownership, necessarily? A. Had no ownership whatsoever.

Mr. McNeil: Thank you. No further questions, your Honor.

The Court: Anything further, Mr. Kinsey?

Mr. Moore: If the Court please, and it is agreeable with Respondent, I would like on recross to ask a couple of questions.

Mr. McNeil: Respondent has no objection, your Honor.

The Court: Mr. Moore, you may proceed.

Mr. Resnick: But the questions would be on redirect and not on recross.

Mr. Moore: Yes.

150 Redirect Examination

By Mr. Moore:

Q. Who did pay in the twenty-five thousand dollar capital that was mentioned, Mr. Brown? A. Mr. Souther and Mr. Kinsey.

Q. Who received the stock certificates for those—for this payment? A. I don't know how many stockholders they had, but I am certain that they received the stock themselves.

Q. Did you receive any stock? A. No stock.

Q. Did you pay in any capital? A. Did I pay in any capital? No.

Q. Did you loan any individuals any money to pay in any capital for Fortuna Sawmills? A. In the Fortuna Sawmills? No.

Q. Did you have any interest in the stock that was issued at all? A. None whatsoever.

Mr. Moore: If the Court please, at this time, there is one matter that we didn't bring out on direct examination that we would like to bring out at this time from Mr. Brown, and it would be considered that it would be direct examination and the gentlemen representing Respondent would have full opportunity to cross examine.

151 The Court: You may proceed.

Q. Mr. Brown, in the negotiations that have been testified to concerning the sale of the stock of Clay Brown & Company to the California Institute, I think you testified that you thought one million five hundred thousand dollars was a fair price and that this was negotiated with the result of one million three hundred thousand dollars, including these notes? A. That's right.

Q. Now, were there any supporting documents at all to justify this price? A. Well, after my first discussions with Mr. Seagrave, which were held in Eureka—we didn't discuss price—I wanted to go back to Portland and talk to the rest of the stockholders, and then with the assistance of my associate, Mr. Booth, we got out the appraisals, prepared by one of the—I am not sure, but I think the General Appraisal Company. Then we had the appraisal brought up to date. The apprasisal at that time was two or three years old, and there had been considerable improvements made. That, plus the earning statements gave us a feeling that the properties were worth—and timber acquisitions that we had—gave us—we felt it was worth a million five hundred thousand dollars, including the notes.

Q. I see. Do I understand then that you used
152 the appraisals which had been—an appraisal which had been previously made and that you had brought up to date and then also used the earning figures to justify your asking price? A. (Affirmative nod)

Q. Respondent and the Petitioners have stipulated that the sixteen pages of the 1951 appraisal from—made by the General Appraisal Company are exhibits and also a 1953 appraisal which brings the prior appraisal up to date have been stipulated to be entered as exhibits. Are these the appraisals that you are speaking of? A. Those are the ones I am referring to.

Q. You testified you received a note for one million three hundred thousand dollars, representing the purchase price, is that correct? From the Institute? The stockholders did? A. A note for that amount less the original down payment, as I recall.

Q. I see, but this—the note and the down payment represented the purchase price of the assets and the notes also? A. Correct.

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153 GEORGE CASTERA was called as a witness by and on behalf of Petitioners and, first having been duly sworn, testified as follows:

The Clerk: For the record, may we have your name and address?

The Witness: George Castera.

The Clerk: How do you spell your last name?

The Witness: C-a-s-t-e-r-a. 651 Siena Way—S-i-e-n-a, Los Angeles, California.

Direct Examination

By Mr. Kinsey:

Q. What is your occupation, Mr. Castera? A. I am President of the California Institute for Cancer Research, at UCLA in Los Angeles.

Q. How long have you been President? A. I have been president since 1952.

Q. And you are the Mr. Castera who signed the purchase agreement? A. I am.

Q. And some other related documents—(interrupted) A. I am.

Q. —on behalf of the California Institute? Would
154 you just explain generally the nature of the Institute's organization? A. Well, the California Institute of Cancer Research was set up by the University of California at Los Angeles Medical Center, as a non-

profit corporation, with the idea of stimulating public interest in the fight against cancer at the University. Dean Warren is medical director, formed the corporation and put on some of his doctors as members of the board, with the idea that little by little as time went on, why, they would be supplanted by laymen. The first president was a Doctor Freedgood (phonetic) and he was transferred to a medical school east and left a vacancy around 1952. Judge Stanley Barnes, who was then on the board of directors and Mr. Phillip Davis, an attorney, and at that time a State senator of California, asked me to have luncheon with them and knowing that I was particularly interested in cancer, having just lost my boy with cancer, they asked me to take on this presidency, to supersede Dr. Freedgood. Well, I wasn't particularly interested, with my other occupations and activities, I thought I was too busy, but my wife was Treasurer of the women's group and she persuaded me to take this presidency, which I did. Now, the Institute since has grown considerably. It has, in addition to its board of directors, all men, some twenty-two, consisting of General Omar Bradley as its chairmen and different business executives—Courtland Gross (phonetic), President of Lockheed, Judge Barnes and men like that, their interest being that they have lost people with cancer and want to do something about it. Now, in addition to that, we have three women's groups and they in turn have their own officers and they are located in southern California. Now, our main objective, of course, is to educate the public in the area that there is this dreadful disease and that they ought to do something about it. They help us in fund raising. The women give three or four functions a year. Each one, they stimulate people to mention us in their wills; money is given in lieu of flowers upon death. The Institute itself sends out numerous letters to the corporations in fund raising. We—with this background of our people, we are able to stimulate the National Cancer Institute and the agencies to put money in there. We have some very very important work going on that in my opinion is outstanding in the country. The medical center itself does more cancer work than all the other universities on the coast put together and a great deal of it is due to the insistence and

pushing and giving money to bring this work about. Mainly, that's our main job.

Q. How did the acquisition of the Brown stock and then its assets after liquidation fit into the scheme of things from the Institute viewpoint? A. Well, the deals
156 were brought to our attention. We looked at quite a number of them. I would say maybe two dozen of them, and we selected two, and our board and myself, or our idea being that eventually, if this ruling of the Congres of 1950 was workable, that we would—and we looked into it incidently in great detail, we would eventually end up with the properties and we could in turn sell them and use the money to fight cancer at UCLA, and that is why we took on this Clay Brown contract.

Q. How did the respective deals come to your attention? A. They were brought in by various brokers in Los Angeles —mostly brokers—stock brokers, people on Spring Street. The two we selected were both submitted by Mr. Seagrave, one of the leading brokers there and was interested in this type of work.

Q. Would you explain your knowledge of the negotiation of the Brown deal? A. Well, Mr. Seagrave originated it and asked me to meet with him at luncheon one day and he submitted the company as a prospect for our taking it on in a contract. We—in turn, I have on our board, an executive committee consisting of seven of the board members. Some of them—one is executive vice president of the bank and a couple of lawyers and one—the Regent at the University—and they told me to look further into it. We had the Vice President of the Security First National Bank at Los Angeles write up here to
157 check into the reliability of the management and we got a very glowing report as to their activities and what they had done in the past, so we told Mr. Seagrave that he could appear before our executive committee, which he did, and he submitted this company as a prospect for our purchase; and after due consideration on the possibilities—checking the local lumber markets and the earnings in the past, we thought that it would pay off in five years so we bought it.

Q. What was the main plum in the deal, so to speak, from the Institute viewpoint? A. Well, we were interested

in hoping that the property would pay off in the five-year time and then we would end up by owning it and in turn could sell it and use that capital for cancer research at UCLA.

Q. And also in the meantime, you got ten percent of—(interrupted) A. Yes, we got ten percent of the earnings during that period of five years. But our main—you asked the question of plum—I would say that we hoped to get the property whereby we could sell it and use that money for cancer research.

Q. Did the executive committee pass on the price? A. Yes, they did. They arrived at the price.

Q. To your recollection, what justified the price?

158 A. Well, those present on the executive committee—myself—oh, I had been a stock broker in business many many years, and I buy stocks and properties on earnings and we had checked the previous earnings and I felt that at the rate that they were earning, on five years, the price—in case they would miss a little bit—a little under a million and a half, which they wanted first, we came to the conclusion that they would make them a million three hundred, so we bought it at that price.

Q. Who—well, recount your recollection of the circumstances connected with the sale of the property to the California Highway Department? A. The five-year period had expired and the property should have reverted back to the owners and we renegotiated a contract with them that we would attempt to put future management in there to operate the property. And we weren't successful. We put one man in. I didn't know him, but he was supposed to be a lumber man that applied for the job and we made a deal with him, but it didn't last very long; so the State had wished to condemn part of the properties. I had never seen the properties, but I had seen photographs of it, and we had an outside counsellor—or I mean an investigator check the property on our behalf. We paid him a fee to tell us what he thought of its value and what could be done with it. He outlined the property in detail. There was

159 a large pond, some fifteen or sixteen acres under water that could be rented and that was exactly the location which the highway engineers had designated to put their new highway. Well, if we had done that, the

rest of the property would be—in our opinion would be not as valuable and we couldn't dispose of it without the pond. So the California engineers came to see me and I talked with them at length about it and insisted that if they wanted the property, they would have to take the whole thing. In turn of course, they could have condemned—by California law, they could have condemned that part alone—the mill pond, but it was very obvious to them after great discussion on it that they would have to move the—we showed them or I showed them that they would have to move the railroad track out of the way and that would have cost them more than buying the whole property, so they decided to buy the whole property. And we sold it to them.

Q. What was the Institute's attitudes or thoughts connected with management of the properties after you acquired them, upon the liquidation of Clay Brown & Company? A. Well, of course, my opinion and the opinion of the executive committee of our board, who were all businessmen, without management, you haven't got anything. We wouldn't be interested—I wouldn't personally be interested in buying a property that required management without having someone there that knew how to manage it. Now, I knew none of the people. I met Clay Brown maybe three years after we purchased the property. I never considered it my duties to interfere or even discuss anything with these companies. I looked upon the companies as an asset, several of which we have now—we get stocks, we get other properties—have had real estate and other things given to us, but I didn't discuss anything with the individuals, but we insisted that they have proper management and the stockholders of the managing company submitted some names and they said that they could run the mill at a profit so we approved of it. Made a deal with them.

Q. Did the Institute request Mr. Brown to continue the management? A. Not to my knowledge—no, I don't think so, but we insisted that we have proper management and that the people in the mill would stay—the operators of the mill, but I don't recall specifying any individual.

Q. Well, how was it that Mr. Brown was retained as manager? A. Evidently—I don't know. That was up to the stockholders of the operating company.

Q. To refresh your recollection on it, there is a provision in the lease between the Institute and Fortuna Sawmills that provides that the Institute can dictate who will be the manager. A. Yes, that's right; that's right. Well, we selected—we approved and we selected the group
161 that was in there to run it and they did very well.

Mr. Kinsey: That's all, your Honor.

The Court: You may cross examine.

Cross Examination

By Mr. Resnick:

Q. Now, Mr. Castera, at the time that you became president of the Institute, was it a tax exempt organization under the Federal Tax Laws? A. Yes, sir.

Q. And since that time, such exemption has been revoked? A. It was about 1957 when we heard of these—we had these two companies and we heard that there was a ruling called the Denver Ruling that—where the Internal Revenue frowned upon these lease arrangements. So we refrained from looking at any more of them but inasmuch as our main objective in this work is to lick cancer, we weren't particularly interested in anything about the finances or obtaining any more of these companies, so one of our directors, Judge Barnes was in Washington, and some of our directors back and forth there all the time, got in touch with him, and they went over to see the Secretary of Treasury, Mr. Humphreys and Mr. Humphreys brought in this senior counsel, Mr. Barnes, by name—I didn't know him either; but they arranged an agreement that rather than to liquidate all this excellent work that had been going on in
162 cancer—as I mentioned here—I will now, that it is the outstanding work in the country today—the research work itself, not our work; that they didn't want anything that would disturb it, so we were told—suggested that if we would set up a new corporation, they would give us an exemption, which we did, and we took all of the assets and all of the members and all the board and moved it into a new corporation and allowed the old corporation to stand as was, with the two lumber companies in them. Immediately after that, with the approval of the code group in Washington of the Internal Revenue, they took away

the exemption of the West Los Angeles Institute for Cancer Research. At the present time, it is a profit corporation.

Q. That is the old—(interrupted) A. That is the old corporation, yes. We renamed it West Los Angeles Institute for Cancer. It's a dormant corporation.

Q. Prior to the Clay Brown transaction, did you or any of your committee members see the mill at Fortuna? A. No, I never saw the mill—I am sure none of our other people had ever seen it.

Q. Did you ever see it after you acquired it? A. No, I was never at the property. I saw pictures of it during the one time there was a big—the Eel River went over and flooded it for about six feet and there was a great attempt to get that river straightened out and I asked General
163 Bradley when he was at his office in the Pentagon the next time he was east to do something about it and he did.

Q. Did you know who the stockholders were of the Fortuna Mills Company? A. No, sir.

Q. Did you have any personnel in the Institute, either on the board or otherwise, who were familiar with the operations or could operate the—(interrupted) A. Mr. Seagrave—Mr. Seagrave was a member of the board at that time and he—he saw the mill.

Q. But was he qualified to operate it? A. Oh, I wouldn't know.

Q. Did the Institute have any funds or resources available with which to purchase the Clay Brown stock for cash? A. If the board of directors so chose, they could have, yes.

Q. What were the financial resources of the Institute at that time? A. Oh, at that time, I don't recall exactly; but the Institute has, sometimes two or three hundred thousand dollars and then the University will do what they call, with grants of aid, will, through a chain of command at the University, ask for the money and it goes down to practically nothing and then it goes up and down,
164 back and forth, depending on how much money they want for research.

Q. Aren't your funds expended almost exclusively for cancer research itself? A. Yes.

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165 Q. At the time that negotiations were being undertaken in connection with the Clay Brown transaction, did Mr. Brown or any of his representatives seek from the Institute financial statements? A. No.

* * * * * * * * * * *

166 CHARLES WILLIAM BOOTH was called as a witness by and on behalf of Petitioners and, first having been duly sworn, testified as follows:

The Clerk: For the record, may we have your name and address?

The Witness: My name is Charles William Booth.

The Clerk: How do you spell your last name?

The Witness: B-double o-t-h. My address is 12912 S.E. Oatfield Road, Milwaukie, Oregon.

Direct Examination

By Mr. Kinsey:

Q. What is your occupation, Mr. Booth? A. I am the Secretary and Treasurer of Clay Brown & Company.

Q. And you are also one of the Petitioners in these proceedings? A. True.

Q. You have worked with me in preparation for some of the data for this case, is that correct? A. Yes, I have

167 Mr. Kinsey: I would like to have marked as Petitioner's Exhibit—whatever the next number is.

The Clerk: For identification, Petitioners' Exhibit 105.

(Whereupon, document referred to was marked for identification as Petitioners' Exhibit 105, Witness Booth.)

Q. I now hand this to you for your inspection. Did you prepare that exhibit? A. I did.

Q. What was the purpose of its preparation and what does it show? A. This is a chart showing the relationship between the net sales average and the direct costs per thousand board feet to manufacture lumber of the operation at Fortuna from the time it began operation until it closed down. This includes both the periods when Clay Brown & Company—the prior corporation, Clay Brown & Company operated it and during the period when it was operated by Fortuna Sawmills.

Q. And the lines going across are graph lines? A. That is correct.

Q. And it shows the continuity between Clay Brown & Company and Fortuna? A. Yes.

Q. And that is possible for this graph purpose, I
168 understand—why? A. The mill never ceased operations, when one took over from the other, so we were able to maintain statistics, if that is what you mean?

Q. No, I meant that in the case of Clay Brown & Company, they would have a depreciation deduction while Fortuna, it's a rental deduction, but these figures are before depreciation and before rental? A. That is correct. I took out the depreciation figures in computing this while it was being operated as Clay Brown & Company so it would be comparable to the figures after assumption by Fortuna.

Q. And the distance between the sales line—the sales realization line and the cost line would represent profit? A. Yes, sir.

Q. And then the figures down below are the actual profit figures—the gross profit and the net profit? A. That's correct.

Q. And these lines have varying degrees of proximity until they finally cross and they cross at what point? A. They cross in 1957 at just before the end of the six month's period that would end the fiscal—or half the fiscal year. It would end in October, 1957. It would be approximately August or September, 1957.

Q. Which is around the time the mill shut down? A. That is right.

169 Q. How do you account for the lines getting ever closer together and then finally crossing? A. There were several factors. One was that the market for lumber generally was dropping. The lumber market started to shade off in 1956, as shown by industry statistics and our figures were no different. Also we had, to some extent, lost a freight advantage, which the mill at Fortuna had previously had for shipments within the State of California. An ICC ruling had made lower rates out of Oregon. Previously, we had maintained a historic freight advantage. We then found that we had more competition from Oregon mills freight-wise. Also, during this period, costs were

rising and as a result, as shown here, these lines cross and we got to the point where the costs exceeded the sales average.

Q. But from 1950, when the mills started operation to early '53—in other words, the double line between '52 and '53 represents when Clay Brown was sold to the Institute, is that correct? A. True. That is right.

Q. Up to that time, the lines were pretty far apart, is that correct? A. Yes, and for part of the period after that, depending on market conditions and costs.

Mr. Kinsey: I would like to offer this as Petitioner's exhibit numbered as marked.

170 The Court: Any objection?

Mr. Resnick: I don't understand its relevance; I don't understand the assumptions made; I don't understand the sources of the data. Perhaps if I take the witness on voir dire, we may be able to obviate that.

Mr. Kinsey: He has all of the supporting information—the same information that was available when we showed it to you three days ago, and he will be able to give you anything you would like on that on cross examination.

The Court: I think he has the right to examine for the purpose of deciding whether or not to make an objection. You may examine for that purpose only now, Mr. Resnick.

Mr. Resnick: Would you like a copy of this, your Honor, while he is examining?

The Court: I have been furnished one, thank you.

Examination on Voir Dire

By Mr. Resnick:

Q. What elements have you incorporated in your direct costs? A. May I have a copy of the chart before I discuss this? (Document furnished)

Mr. Kinsey: If you desire your file at any time, request it and we will bring it up to you. A. Thank you. The net costs include all of the cost of manufacturing the

171 lumber with the exception of depreciation through shipping, but excludes administrative costs. It includes the cost of the logs and all the manufacturing costs.

Q. Is freight included in your direct costs? A. No, sir, because we—freight is not—normally, we refer to our sales average as the average sales price at the mill.

Q. Was any part of the overhead burden incorporated into the graph? A. No, it was not.

Q. I notice you have a legend at the right side of the graph, at the bottom, where you say that you have included the cost of logs less depreciation and rent? A. Yes.

Q. Do you mean that—the depreciation is not that depreciation that relates soley to logs? A. No, sir.

Q. What was the source of the information? A. I took this information from the working papers of Fortuna Sawmills. I was the controller of Fortuna Sawmills and in that capacity, was in charge of the monthly records which we prepared and worked with the auditors at the time of the annual audit.

Q. Were you also the controller of Clay Brown & Company prior to the February 1953 transaction? A. I was the Secretary and Treasurer of Clay Brown & Com-
172 pany and acted in the same capacity.

Q. Were the figures that you seek to chart out on Exhibit 105 for identification the figures that were used in determining the payout to the Institute for its rent? A. Except for the fact that in determining the Institute's —the rent for the Institute, we included administrative and sales costs, which were not included in this chart.

Q. What were the administrative costs that were excluded? A. Office help in the sales office; commissions payable to the sales personnel in our sales offices; and the general office overhead, except for at the mill office. The mill office costs were included.

Q. What about the sales expense in the Clay Brown Company portion of the graph, on 105 for identification? Have they likewise been excluded? A. They have, yes. These were prepared on the same basis.

Mr. Resnick: I have no objection to the receipt of the exhibit.

The Court: The exhibit will be received.

The Clerk: Exhibit 105.

(Thereupon, Petitioners' Exhibit No. 105, Witness Booth, received in evidence.)

The Court: May I just ask a question? When you
173 were referring to the sales, you said they were sales at the mill, did I understand you correctly?

The Witness: Yes. What I meant was, the sales realization at the mill. Actually, there was freight involved. The lumber went elsewhere for disposition, but we figured the net return at the mill before the freight is involved in shipping it out.

The Court: In other words, you took what was paid to you for it and subtracted the freight from that?

The Witness: That's quite true, and quite often, the sales were made at the mill level. The customer might send his truck to the mill and pick it up there, so that freight was not always involved. In order to get a comparison and a steady average, we excluded freight from everything. But if it was sold on a delivered basis, for example, f.o.b. at Los Angeles, California, then we deducted out the freight cost to come back to the mill—realization at the mill.

The Court: Thank you.

Continued Direct Examination

Q. (By Mr. Kinsey) Mr. Booth, you stated that overhead is not shown on the graph? A. That's right.

Q. By that, you mean on either of the two lines? A. That is right.

Q. But in the figures down at the bottom, there
174 is gross profit and net profit; and the net profit—the difference between gross profit and net profit is that overhead is deducted off the gross profit to arrive at net profit? A. That's right, yes.

Q. So on the paper as a whole, it does show net profit after overhead, but it is just the lined graph does not? A. That is true. The figures at the bottom show that. The line graph does not.

Mr. Kinsey: In view of that, would you have any other questions you would want to ask, Mr. Resnick?

Mr. Resnick: Not on the exhibit. I have no objection to its receipt.

Q. Another question in relation to this—to your knowledge, when Clay Brown & Company was sold to the California Institute, could the trend of these lines have been anticipated at that time?

Mr. Resnick: I'm sorry, I didn't hear the question.

Q. Could the trend of these lines have been anticipated on February [redacted], 1953, at the time Clay Brown & Company was sold to—(interrupted)

Mr. Resnick: I object, your Honor. The witness hasn't been qualified as one who can give an opinion as to economic trends in the lumber market. In the absence of such qualification, I don't believe that an opinion can be given by him.

175 Mr. Kinsey: We may recall Mr. Clay Brown for that, but maybe as a second class expert he can answer.

(Laughter)

The Court: Well, it will be received—the witness' opinion. He apparently has been in the lumber business for some time and you may cross examine him as to his qualifications as well as otherwise. A. My opinion is that the trend of these lines could not have been shown, nor could anyone even today project for five years what the lumber market or costs of manufacturing lumber are going to be with any degree of accuracy.

Q. Now, at the time the sale was negotiated, Mr. Brown testified, I believe, that you participated in the generation of the figures or data that justified the price you were asking? A. That's right.

Q. Would you explain what you did in that connection and the negotiations relating thereto? I think you are aware of the letters that you have written and received in that connection, which are in the stipulation. A. Yes, I was asked to prepare several schedules on several occasions, showing the assets as they were and as—relating to the—initially relating to the appraisal we had taken in 1951 and to look over other assets that may not have been included in the appraisal and there were some, such
176 as land, for example, and timber was not included in the apprasial; and to make up schedules showing a more realistic approach to the actual values of these assets, and then, after it was decided that a revision should be made of the appraisal, to bring it up to date, I was again asked to go over those figures and to analyze them and to present them in a pro forma balance sheet to show what might well be termed actual values of the assets of the corporation.

Q. Now, what's the difference between the pro forma balance sheet you talked about and the actual balance sheet? A. The actual balance sheet, of course, would have been the Clay Brown—(interrupted)

Mr. Resnick: If your Honor please, unless we have the balance sheets in front of us and are somewhat identified I think the question is completely meaningless.

Mr. Moore: I think they are in the stipulation.

Mr. Resnick: Then they should be identified if they are in the stipulation and they should speak for themselves.

Mr. Kinsey: I think that is a good point. I will identify them. If the Court will pardon us for—(interrupted)

Mr. Resnick: If Mr. Kinsey will tell us what he hopes to establish by this witness that hasn't already been established in the one hundred and five exhibits, perhaps
177 we can agree with him.

Mr. Kinsey: Oh, fine. What I was going to establish was that he took the actual balance sheet of Clay Brown & Company of recent date—that is, recent date to February 4, 1953, which showed book values; then in place of the book values, he substitute actual values and then I was going to question him as to his source of the actual values and then I was going to ask him how close the total came to a million three and that was the line of questioning.

Mr. Resnick: Everything you say is fine, except I don't understand what you mean by actual. If you meant by that, the values per the appraisal, then, of course, those figures are already in the record too.

Mr. Kinsey: I think they would be a very strong indication of actual value, but I wasn't necessarily—(interrupted)

Mr. Resnick: Well, I don't know. They would be the values that appear in the appraisal. Your definition of actual and mine might be different.

Mr. Kinsey: Well, if you are telling me what his answer as to actual value would be, that may well be, but perhaps the witness can answer just as well.

The Court: You may proceed, Mr. Kinsey.

Q. I hand to you Exhibit 28-BB, 27-AA—I believe those are the two letters written by you. Now, in those let-
178 ters—I am talking about two exhibits, and maybe you can identify which of the two this statement would

apply to—you show where in—I use the term actual values, you can use whatever term you choose—should be substituted for the book values as taken off the financial statement, is that correct? A. Yes.

Q. What term would you choose—did you use in those letters? Should we use—rather than actual value—(interrupted) A. Reconstructed valu .

Q. Reconstructed value?

Mr. Resnick: What value d you use in the letter, sir? A. The schedule attached to Exhibit 28-BB, shows a value of one million five thousand sixty dollars.

Q. Now, how did you arrive at that figure? Maybe if you would just explain how you generated that figure, you will answer all the questions I want to ask? A. I might explain that this was prepared prior to having the new appraisal—before the appraisal had been brought up to date. I took the assets as shown on the books of Clay Brown & Company; then I added several assets which had been added or improvements which had been made of a capital nature, since the appraisal.

179 Q. Did you use book values on the additions? A. Yes. For the most part. In some instances, I didn't. For example, I showed four automobiles, present value, ten thousand dollars, that was an estimate. And I showed timber. That was an estimated value, but in the other instances of actual—where we actually purchased assets for installation at the mill, I used actual values. Where I had the actual figures, I used them. And then I have a column in this exhibit, as you will note, that says "plus items expensed". Sometimes it was difficult if not impossible to keep the crew who were building at the same time were making lumber, separated and it was felt that a good deal of the construction and the addition to the capital values of the mill did not reflect in the figures. It might have ended up as cost of operation, so those were added, and in that manner, I came to a million five thousand dollar figure.

Q. To what extent in that did you use the appraisal, which as you explained was the appraisal before the updating one? A. I used it as a basis for almost the entire list—the appraisal I have listed as in the first column here, coming down to the total as shown on the appraisal.

Q. Then what were the circumstances about the subsequent appraisal? Why was that gotten and so forth? A.
180 Because of the fact that we had added quite a number of assets and because of increased costs of replacement, there was inflation at the time, and it was indicated that the cost of these items would be increased to get actual value at January 1953, so for those two reasons, it was decided to be more accurate and better documentation if the appraisal were brought up to date.

Q. And it was brought up to date? A. Yes, it was.

Q. Are you the one who contacted the appraisal company to have it brought up to date? A. I don't recall where I made the first contact. I do recall that I talked to Mr. Dean of the General Appraisal Company about the situation and asked him to do it.

Q. Did he know the purpose of the appraisal? A. I presume he did.

Mr. Resnick: I move that that be stricken. The answer is obviously hearsay.

A. I am not sure.

The Court: Well, he says he is not sure, Mr. Resnick, so I don't see much point in striking it.

Q. Anyhow, the purpose of the appraisal was to arrive at what? A. To arrive at values of the equipment for replacement purposes and depreciated values and I presume—I won't say I presume—and for insurance
181 purposes, which is always done in appraisals of plants. They give you three schedules of values.

Q. Three schedules? Maybe we should have that appraisal. I will hand you Exhibit 31-EE—and that is the subsequent appraisal? A. That is right.

Q. What impact then did that have upon that reconstructed value you said you used without benefit of the updating appraisal? A. This indicated the plant was more valuable than we had anticipated. We found additional values by having the appraisal made—or the appraisal brought up to date.

Q. It more than substantiated then the figures that you have in your reconstructed value? A. Yes.

Q. By reconstructed value, I mean in your letter under your label reconstructed value? A. That is right.

Q. Under what heading were the figures—what is the heading on the column of figures in the appraisal that you took off for your reconstructed value? A. The heading is "new replacement value".

Q. New replacement value? A. Yes.

Q. And that figure has a depreciation factor in
182 it. What would—is that right? A. Yes, that's right.

Q. In other words, if it's two years old, they don't give you the cost of a brand new one, but they give you the cost of what a—(interrupted)

Mr. Resnick: If you are going to testify, Mr. Kinsey, you ought to be sworn.

Q. You explain. You can explain it better than I can. A. I will explain it to the best of my ability. The new replacement value is the estimate of the appraisal company as to what it would cost today to put similar equipment in place at that time.

Q. Of the same aged equipment? A. Yes.

Q. Not new equipment, but the same aged equipment? A. That is right, and Mr. Dean told me at that time that the appreciation—in other words, inflation—the cost of replacing this type of machinery was such that he felt that depreciation offset—was offset by increased construction costs for replacement purposes.

Mr. Resnick: I move that that part of the answer which begins "Mr. Deal told me" be stricken as hearsay and not binding on the Respondent.

Mr. Kinsey: I would say in opposition to the motion that he is explaining the background for some figures
183 he has used that are a stipulated exhibit.

Mr. Resnick: The exhibit may be stipulated, but we didn't stipulate to what Mr. Dean told him. If you want Mr. Dean to tell us something, Mr. Dean should be here.

The Court: The motion is overruled.

Q. Now, in your reconstructed value—I guess you can put that one exhibit down, if you want. In the reconstructed value, what did you have the timber in at? A. Mr. Kinsey, we made two or three different projections here, as we were going along, and I want to be sure that I understand what reconstructed value we are talking about. Are we talking about the one before the new appraisal? Or after the new appraisal—after the appraisal was brought up to date?

Q. Well, you come up to a figure of a million something, don't you? A. In both cases.

Q. What is it in one case—what is it before the new appraisal? A. One million five thousand sixty-eight dollars.

Q. What is it after the new appraisal? A. I don't have those figures in front of me. I have them, however, back there. In my other records.

184 Q. Subject to your verification, was there much of a variation? A. Not a great deal. I believe it was about a million fifty thousand.

Q. Well, in the one that you have there, what value is the timber at? A. One hundred and twenty-three thousand dollars.

Q. And that was how much per thousand? A. Eight dollars and twenty cents based on fifteen million feet.

Q. Now, how did that prove out, using—substituting hind sight now for the knowledge you had then? A. Actually, out of the timber, there was more than twenty million feet harvested.

Q. And what was the—do you have any reason to substitute or use a different value than the—(interrupted) A. Yes, we had an appraisal made by a timber—Mr. Reardon (phonetic), a timber salesman and timber broker in Eureka. He figured that nine—he gave us a letter, nine dollars per thousand feet was at that time about the value of the timber.

Q. That letter is in as an exhibit. We will identify the number—but you are acquainted with that letter? A. I am.

Q. We will give you the date on it, but it was prior to December—it was prior to February 4, 1953, it was some time in 1952? A. I think it was.

185 Q. But rather than using the nine dollar figure, you used—(interrupted) A. Eight dollars and twenty cents.

Q. So if you used actual values—I mean actual quantities as proved out by subsequent operations, and the nine dollar figure, what would you get? A. We would have increased this fifty-seven thousand dollars.

Q. But even without the increase of the fifty-seven thousand, your total was one million what again? A. One million five thousand sixty-eight dollars.

Q. And then how did you justify the difference between that and a million three? A. Partially on earnings record; partially on the fact that it was a going corporation and it was difficult to buy machinery in those days and to get quick delivery, and we had a mill. We had it in operation and it was showing profits and these were some of the factors that were considered. We had a sales organization. It was doing a good job for us. All of these were tangible to us and was a factor that we felt justified a purchase price in excess of these reconstructed values.

Mr. Kinsey: For purposes of the record, that Reardon letter is dated May 1, 1952, and it is Exhibit 81 quadruple C.

186 Q. Did Mr. Seagrave question your values? A. Yes.

Q. Did you convince him? A. Yes, we did. I think we did. We seem to have.

Q. But anyhow, the price evolved at a million three? A. Yes.

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187 BEFORE THE TAX COURT OF THE UNITED STATES

Transcript of Hearing—January 28, 1961

U. S. Court of Appeals
U. S. Courthouse (New)
Portland, Oregon
Thursday,

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188 CHARLES WILLIAM BOOTH resumed the stand and testified further as follows:

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Continued Direct Examination

By Mr. Kinsey:

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189 A. At this stage of the negotiations, we were asking a million three hundred thousand dollars for the stockholders.

Q. For the stock alone? A. For the stock alone.

Mr. Kinsey: That's all on this exhibit.

Q. Now, the spread between your reconstructed asset value and your asking price, you supported how? A. By the fact that good earnings were behind the corporation and that it was a going concern and that it would take time to build another similar facility as well as difficulty in getting machinery and so on. Primarily because of the good earning record.

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Q. Now, getting to Fortuna and its organization, did you attend the conference at which you might say its birth was decided upon? A. Yes, I did.

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Q. Would you recount your understanding of that birth?

Mr. Resnick: Object, your Honor. I think we should have a foundation laid—time, place, persons present if the witness wants to recount what was said there. That might be unobjectionable, but his impressions of a conference the date of which and the place of which—(interrupted)

192

Mr. Moore: We will ask the proper questions.

Mr. Resnick: We suggested that a long time ago.

Mr. Kinsey: Well, then I thought it might be leading. If we might suggest to him that there was such a conference.

The Court: In light of the objection, would you be willing to lay a foundation? Then I won't rule on the objection.

Q. Yes. What was the approximate time of the conference? A. Late in 1952—probably in Decemebr, 1952.

Q. Where was it? A. It was in the offices of the U. S. National Bank Building.

Q. Who was present? A. Mr. Seagrave, Mr. Souther, Mr. Brown and myself. Are the ones I recall. There may have been someone else.

Q. And then—you can go on with your recounting of the birth of Fortuna? A. As I recall, there had been, on our part, an assumption that—it was known that an operating company was to be formed. We had not up to that point discussed to any great extent who would supply the operating company, and when we reached this point in the negotiations, it became necessary to establish such a company or to have one established or set up or arranged for; and as I recall, Mr. Seagrave was asked if the Institute wanted to provide an operating company or any suggestions in that respect; and there was no

193

suggestion there and Mr. Brown was asked if he had someone in mind and he turned to Cal Souther, who was there, and said, "Why don't you serve the company, Cal?" And I don't recall that Souther accepted right then, but I do recall that that was the time at which this subject was broached to him.

• • • • • • • • • • •

194 CHARLES WILLIAM BOOTH resumed the stand and testified further as follows:

Cross Examination

By Mr. Resnick:

• • • • • • • • • • •

195 Q. On how many occasions did you meet with Mr. Seagrave? A. I don't know. I would—do you want an assumption?

Q. Your best recollection? A. Probably three or four prior to the end of—during the negotiations.

Q. When did your first meeting take place to the best of your recollection? A. First meeting took place in the offices of Mr. Boone, of Dean Witter & Company.

Q. Who was—who were present at that meeting other than you and Mr. Seagrave? A. Mr. Boone.

Q. Was Mr. Brown there? A. No, he was out of town.

Q. Did all your meetings take place here in Portland? A. Yes.

Q. You didn't meet with Mr. Seagrave in Los Angeles? A. No.

Q. Do you know whether Mr. Brown met with Mr. Seagrave at times when you weren't present? A. Yes, he did.

Q. Some of those meetings were held outside of Portland?

A. Yes, I know of at least one in California—in

196 Fortuna.

• • • • • • • • • • •

197 A. Oh, yes.

Where was that office? A. In the United States National Bank Building in Portland.

Q. That was the office that was also occupied by Mr. Clay Brown? A. Oh, yes. No reason to change.

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198 LOUIS H. SEAGRAVE was called as a witness by and on behalf of Petitioners and, first having been duly sworn, testified as follows:

199 Cross Examination

By Mr. Resnick:

. . . . . .

200 Q. Were you and your partner Mr. Rea—R-e-a—at one time authorized by the Institute to seek out businesses that the Institute might acquire? A. Yes, that is correct.

Mr. Resnick: We have no further questions of the witness at this time.

The Court: Is there anything further, Mr. Kinsey?

Mr. Kinsey: I just have one question which may actually be resumption of direct, if I may.

Redirect Examination

By Mr. Kinsey:

Q. I refer to Exhibit 55 triple C, which are the minutes of a special meeting of the board of directors of the California Institute for Cancer Research. They disclose that you were chairman of that meeting and I am reading from the second page of the minutes. It says: (Reading) "Mr. Seagrave then received—or reviewed, rather the proposed purchase of Clay Brown & Company of Portland and Eureka and submitted various papers which are attached to the minutes of this meeting. He disclosed that his interest was a two percent commission to be paid by the sellers when and if payments on the purchase price are made." Did you receive a commission pursuant to that? A. The commission was established and some payments were

201 made; however, the amount of payments made did not anywhere near cover the expenditures I had made. There was no profit in it.

Q. And Mr. Boone testified that he got one percent. So does your recollection—(interrupted) A. His company got one percent.

Q. There was a three percent commission? A. That's right.

Q. Two percent to you; one percent to Mr. Boone? Or to Dean Witter? A. That's right.

Q. Further on in the minutes, there is a resoultion that says that a legal committee is hereby appointed to consist of Mr. Phillip Davis, Judge Stanely M. Barnes, Judge Frederick F. Houser, to go over the agreements and make any revisions they felt to be in the best interest of the Institute and to pass and approve other documents in connection with the proposed purchase. This is talking about the Clay Brown purchase. I, together with counsel for Respondent, have reviewed the minute books of the Institute and we don't find any minutes specifically showing that the legal committee did approve those documents. Did that legal committee approve the agreements? A. Yes, and I can tell you the circumstances, if that would help to make you understand.

202 Q. Yes, fine. A. I believe that I had indicated that I would like to have them okay them by noon of a certain day, because I was scheduled to go up to Portland for the closing. They had had these documents and they hadn't quite completed them. They got together—at least two of them—the two judges. They completed their examination and the approval was conveyed to me. I promptly went to—up here and we concluded the arrangement. It was oral, but I talked to each one of them over the telephone. Probably the only reason for it not being covered was that they had been appointed, everyone knew they had acted, and I was away for quite a little while and perhaps neglected to note the minutes.

. . . . . .

CLAY BROWN was recalled by and on behalf of Petitioners and testified further as follows:

Direct Examination

203 By Mr. Kinsey:

Q. I refer to Exhibit 105—that is Petitioners' Exhibit 105—this is a chart that Mr. Booth prepared which I think you have previously inspected. I believe it is disclosed in that chart and in other testimony, things did not go exactly as anticipated, but going back and looking at it as of the time of negotiations, February 4, 1953, and a little prior thereto, during the period of negotiation, what were your prospects for the business—your reasonable prospects?

Mr. Resnick: As of what date?

Q. As of for the future.

Mr. Resnick: As of what date are you—(interrupted)

Q. As of January or February, 1953? A. We looked upon the market as very favorable. We saw no reason why it shouldn't carry on at that particular time for more or less of an indefinite period; and looking at this chart, it shows that sales carried on in pretty good fashion with a margin of profit and to about the third or fourth quarter of 1957. We had every reason to believe and our calculations were based upon that, that our earnings would be maintained to a reasonable sum or amount and I think this chart pretty clearly indicates that. Now, the change in the market conditions was certainly beyond the control of our company or any other company, identified in the same industry.

204 We had a recession there; housing starts dropped off; money got a little tight at that time; costs were increasing, but we couldn't forsee all of that. Possibly some of it—we couldn't forsee a sharp break which occurred here in the drop in sales in the third and fourth quarter of 1957.

Q. Well, then, as of that period we talked, you had, in accordance with your best business judgment, no idication that any bloom was off the rose, so to speak? A. None, other than the fact that historically, we have had our ups and downs in the lumber business, but the line has been in this direction and certainly, we would be in a recession for a short period of time and then it recovers. But in this particluar instance, it hasn't, and as of this date, there hasn't been any material increase. As a matter of fact, it is even worse today, market-wise and costs are still higher. Manufacturing costs.

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CLAY BROWN & COMPANY
Portland, Oregon

STATEMENT OF GROUNDS FOR APPLICATION OF BENEFITS OF SECTION 443

Fiscal year ended April 30, 1950

The company has applied, in accordance with Section 447(c) of the Excess Profits Tax Act of 1950, for permission to compute its excess profits credit under the provisions of Section 443 of the Act, and in support of such application, the following statement of the grounds upon which the taxpayer relies was submitted.

The company, an acquiring corporation, was incorporated on September 28, 1946 and began business on October 1, 1946, succeeding a partnership formed on July 1, 1943 which carried on business under the name of Brown-Ross Company, until March 1, 1946 and under the name of Clay Brown & Company until acquired by the company under Section 112(b)(5).

The company qualifies as an acquiring corporation as defined in Section 461(a)(1)(D) of the Act and is thus deemed to have commenced business on or before the first day of its base period (Section 461(d) of the Act), thereby meeting the requirement of Section 443(a).

The excess profits net income for the base period has been computed in accordance with Section 462 of the Act in a schedule attached to Schedule EP-2 (Form 1120) in order to determine the monthly average for the period as required in Section 443(a)(3).

Prior to the taxable year beginning October 1, 1949 and ending April 30, 1950, which year has been designated in Schedule EP-5(C)—line (C) as that in which a substantial change in products or services furnished by the taxpayer first occurred, the company operated as a broker engaged in the sale of lumber products on a strictly commission basis without handling the products sold. Unable to operate profitably due principally to insufficient volume, the company decided to become a lumber manufacturer and sell its own products. It secured a guaranteed log supply in the Humboldt (California) area, purchased a farm in Fortuna, California, and tore down the farm buildings and

[illegible] began building a sawmill and log pond in August, 19[illegible] which was completed in December, 19[illegible]. The first log[illegible] were delivered only in December, 19[illegible], and the first log[illegible] were sawn the [illegible] later, in the same month, and the company had lumber available for sale to customers prior to December 31, 19[illegible].

SCHEDULE EP-2 COMPUTATION OF EXCESS PROFITS NET INCOME—BASE PERIOD

Fiscal year ended April 30, 1952

	Predecessor Rivers Bros. Company 7/1/45-3/29/46	Predecessor Clay Bros. & Company 4/1/45-9/29/46	Fiscal year ended 9/30/47	Fiscal year ended 9/30/48	Fiscal year ended 4/30/49	Short year 10/1/49-4/30/50	Total Schedule EP-5(c), Line 2
1. Normal tax net income	$ (1,729.59)	21,754.00	62,613.59	100,894.54	(6,179.96)	5,729.53	
2.							
3.							
4.							
5.							
6.							
7.							
8. Dividends received credit				222.75			
9.							
10.							
11.							
12.							
13.							
14., 15., 16.							
17. Total of lines 1 to 16, inclusive	(1,729.59)	21,754.00	62,613.59	100,669.29	(6,179.96)	5,729.53	
18. Dividends received		220.53		275.00			
19. Capital gains							
20.							
21., 22., 23., 24.							
25. Total of lines 18 to 24, inclusive		220.53		275.00			
26. Excess profits net income (line 17 minus line 25)	(1,729.59)	21,533.26	62,613.59	100,621.29	(6,179.96)	5,729.53	
27.							
28. Excess profits net income for base period months years prior to year in which entitlement change occurred	—	21,533.26	62,613.59	100,621.29	—	—	185,769.74
Number of months	3	7	12	13	12		45

CLAY BROWN & COMPANY

DEPRECIATION SCHEDULE

Year ended April 30, 1952

	Age when acquired	Assets				Allowance for Depreciation			
		Balance 4/30/51	Additions	Sales and Retirements	Balance 4/30/52	Balance 4/30/51	Current year's provision	Sales and Retirements	Balance 4/30/52
Buildings	Various	$126,698.49	6,851.96	—	173,550.45	3,995.33	3,373.96	—	17,442.29
Equipment and facilities	New	370,798.30	21,098.13	—	427,283.43	30,880.04	34,256.62	—	30,935.66
Automotive equipment	New	19,807.69	21,191.89	6,595.35	34,404.23	4,690.73	8,837.27	1,840.83	11,687.12
Furniture and fixtures	New	13,243.37	1,453.80	100.80	15,227.37	2,457.38	1,233.14	56.13	3,634.39
		$577,113.35	30,593.14	6,794.95	650,971.84	35,573.50	48,700.99	1,907.61	83,699.48

Life used in accumulating depreciation

Buildings	30 years
Equipment and facilities	5-15 years
Automotive equipment	4 years
Furniture and fixtures	15 years

210 **Exhibit 23-W**

DEAN WITTER & CO.
Portland 4, Oregon

November 28, 1952

Mr. Lewis H. Seagrave
395 Patrician Way
Pasadena 2, California

Dear Mr. Seagrave:

Subsequent to your call to our office in Portland, I have contacted Mr. Clay Brown of Clay Brown & Co., Inc., and he has indicated an interest to proceed with the possible sale of his company to the California Institute for Cancer Research.

Enclosed you will find statements for additional years together with the statement for August 31st, 1952. The current 6-months statements Mr. Brown has with him and they are substantially better than those for 1951.

Also enclosed is a photograph of Clay Brown & Co., Inc., which, even though it is considerably out of date, will give you the general idea as to the scope of this operation.

Mr. Guy Witter attempted to contact you for the purpose of arranging an interview between you and Mr. Brown today, November 28th, but I understand that he was unable to do so. However, Mr. Brown will be spending the week of December 1st to 6th at his plant in Fortuna, California, and would be very pleased to have you come up and see for yourself, should the enclosed facts and figures appear attractive for your consideration.

Should such a visit be possible, I would appreciate your contacting Mr. Guy Witter in our Los Angeles office so that he can inform me in order that I may be able to schedule a mutually agreeable time for you and Mr. Brown to meet.

211 In proceeding, I believe that this company qualifies along the schedule you left with me. Mr. Brown's offer is the 32,000 shares at $40.00 per share or 1,280,000 dollars with a cash down payment. It appears to me because of the current ratio of the company that it is not likely that such a down payment could be made so his other offer is $45.00 per share for the 32,000 shares with no down

payment. Mr. Brown has agreed to pay Dean Witter & Co. a 2% commission for negotiating this transaction.

I enjoyed very much meeting you and hope that some mutual agreement can be worked out.

Yours very truly,

DEAN WITTER & Co.
William B. Boone

WBB/pf
enclosures

212 **Exhibit 24-X**

PROCEDURE IN INSTALLMENT SALE OF ALL STOCK OF A CORPORATION TO THE INSTITUTE, A TAX-FREE CORPORATION

1. To qualify, the corporation must be closely held, have a good and relatively steady record of earnings, have a strong and liquid net current position, own valuable fixed assets, and show the effects of good management. Fixed assets should include 50% land and buildings.

2. All of the stock of the corporation is sold by the owners to the Institute for an agreed price. The Institute gives its note for the purchase price.

3. The Institute dissolves the corporation, becomes possessed of the corporation's assets. It may pay the sellers as a down payment, an agreed amount of cash from the corporation's assets.

4. A real estate trust deed, and a blanket chattel mortgage covering the fixed assets of the dissolved corporation, are deposited with the sellers as security for the unpaid Institute note.

5. Under some circumstances a loan may be negotiated on the fixed assets in order to provide funds with which to increase the down payment.

6. A new operating corporation is formed with *nominal* capital, and this new corporation enters into a five year lease agreement with the Institute covering all the fixed assets received in the corporation's dissolution and agrees

to pay an annual rental therefore of an amount equal to *80% of the new company's net earnings before taxes.*

7. The new company also buys the net current assets, taking over the current assets and assuming the current liabilities. The new company gives its note, payable over a period of years, for the amount of the net current assets. This note is deposited as additional security for the Institute's note to the seller.

8. The Institute will subordinate its note from the lessee company to reasonable bank loans of the new lessee company, thereby making bank loans possible, and improving its credit position.

9. No fixed assets may be sold by the Institute without the approval of the seller, and the entire proceeds of any such sales are applied immediately on the Institute's purchase note held by the seller, without any deductions.

10. The Institute also pays on its note held by the sellers, annual amounts equal to 90% of all rentals received on its lease to the new operating company.

11. When the Institute's note has been paid, the rental on the lease to the new operating company is ordinarily reduced to 60% of net income before taxes.

213 12. The seller or sellers, as a group, may own a minority interest, usually 40% to 45% of the new company's stock, but none of the sellers may be directors or corporate officers of the new company. However, the principal seller, or president of the present corporation or his nominee, is usually employed at a salary comparable to his former salary as general manager of the new company with full powers to operate the new company. Other key personnel may be employed as assistants to the general manager.

13. The new operating company may be owned by the sellers (up to 45%), key employees, bankers arranging the transaction, friends, lawyers, accountants, or others in whom confidence is reposed.

14. Due to provision of the 1950 Federal Income Tax Law, a lease arrangement with a lessee corporation may

not be for more than five years. However, a new lease may be entered into with another corporation, with other owners, officers and directors, in which the present sellers can likewise own such a minority interest.

15. The sale by the seller to the Institute, and the agreement on the lease between the Institute and the new operating company, must be at complete arms length with no overlapping of officers or directors.

16. All transactions must be entirely revealed, with all pertinent information, agreements, understandings, oral or otherwise, supplied to the Treasury Department, which has over a period of years, passed many transactions generally patterned on this outline.

17. Under this pattern, the income of the Institute is tax exempt. Also, if not more than 30% is paid to the seller on the note in the first year, the transaction qualifies as an installment sale, and the taxes on the long-term capital gains resulting are due only in installments proportional to the amount paid on the note in any one year.

18. The Institute will recognize reasonable commissions or fees to be paid by the sellers to persons arranging the transaction.

19. Upon an agreement in principal, the Institute will put the plan in the form of a bona fide proposal, subject only to:

a) The usual and satisfactory investigation by our representatives on the ground. This would include an appraisal of fixed assets.

b) The ratification by the Board of Directors of the California Institute for Cancer Research.

c) An audited balance sheet and priced inventory.

214 ADVANTAGES OF SALE OF A GOING BUSINESS TO CALIFORNIA INSTITUTE FOR CANCER RESEARCH

Many owners of a closely held, successful business find it difficult to get any considerable part of the corporate profits into their personal possession, after providing for both corporate and personal federal and state income taxes.

Working with the California Institute for Cancer Research, we have been able to solve this problem for a number of owners of sound concerns, having a strong current position, and valuable fixed assets consisting of land, buildings and operating equipment, achieving the following for the sellers:

1. They can sell their business to the Institute for more than they can sell for cash, for payment over a period of years, frequently with a substantial down payment.

2. They continue to control the business operation and to draw their regular salary, and retain an interest in the profits as well, until they are ready to retire.

3. They pay only a long term capital gains tax (26% federal).

4. They protect their families from estate, inheritance and final income taxes, which, with their chief assets still invested in the company, would have been ruinous.

5. They avoid the perplexing predicament of either paying prohibitively high personal taxes on distributed corporate earnings, or risking heavy penalties under Section 102 for unreasonable accumulation of surplus if earnings are not distributed.

6. They eliminate the risk that after the death of owners, the business may be subjected to a forced sale or liquidated at possible disastrous loss to their families.

7. They avoid the risk of the business being ruined by incompetent management if sold to others for payment on an installment basis, before the owners have been paid in full.

Our firm is in a position to tell owners how they can go about arranging such a sale, the full details of the transaction, more about the benefits, with the special advantages applicable to the particular situation, *without cost to the owners.*

215 Owners wishing to explore this program, can consult us in strictest confidence. All we ask is their

promise to continue to work only with us until they determine definitely whether or not they will sell at the price and terms obtainable.

The following information is needed:

1. Nature of business.
2. The balance sheet net worth.
3. Your estimate of actual net worth.
4. Estimated earnings before taxes for the current fiscal year.
5. Average net earnings before taxes for at least the past three years (for ten years, if available).
6. Current assets.
7. Current liabilities.
8. Cash and marketable securities (or other properties).
9. Book value of fixed assets.
10. Estimated present value of fixed assets.

LOUIS H. SEAGRAVE
Corporation Finance

216 CHECK LIST FOR QUALIFYING DEALS FOR SUBMISSION TO NON-PROFIT CORPORATIONS

1. The ownership must be in the hands of a few individuals and their families, unless an arrangement can be effected by deposit of stock or otherwise for assuring the deal of ownership.

2. The business must have been operating for a number of years and show the effects of good ownership and sound management.

3. The business must have a strong and liquid net current position.

4. The business must own valuable fixed assets constituting, at appraised values, substantially more than 50% of the purchase price.

5. Land and buildings must be included in the fixed assets and should constitute 50% or more of the fixed assets.

6. The management must be continued for at least a five year period in the operation of a new operating company, and effective steps must be taken to insure the continuity of good management.

NOTES:

A) The new operating company may be formed with a small operating capital since the Institute will, if requested, subordinate its note from the lessee company to reasonable bank loans and to ordinary business creditors.

B) The sellers may, as a group, including members of their immediate families, own a minority of the stock of the new lessee company.

C) The tax free status of the transaction limits the period of a lease to five years under existing Internal Revenue regulations.

D) All commission must be paid by the sellers and will ordinarily amount to 5% of the amount for which the business is sold.

217 ASSUMPTIONS

1. Seller sells all stock of operating company to Institute for $1,000,000, for which Institute gives note, secured by real and chattel mortgages.

2. Operating company is dissolved.

3. Payment at closing on purchase by Institute of $100,000 from assets received in dissolution.

4. Institute sells current position to new lessee company for $475,000 for which it receives note of lessee company, which is also deposited with seller to secure its note to seller.

5. New lessee company is capitalized for $25,000, of which seller buys 45% of stock and balance, or controlling interest, is purchased by friends (not family) of seller.

6. Seller is General Manager of new lessee company.

7. Earnings of new lessee company estimated at $300,000 per annum before taxes.

218 ASSUMED ANNUAL PAYMENTS ON PURCHASE

Net before taxes of lessee company	$300,000
20% retained by lessee company	60,000
80% paid to Institute as rent	$240,000
10% of rent retained by Institute	24,000
Paid to seller	$216,000

219 ASSUMED PAYMENT SCHEDULE

Price	$1,000,000
Payment at closing	100,000
	$ 900,000
1952 Payment	216,000
Balance Due	$ 684,000
1953 Payment	216,000
Balance Due	$ 468,000
1954 Payment	216,000
Balance Due	$ 252,000
1955 Payment	216,000
Balance Due	$ 36,000
1956 Payment	36,000

Note: Average net earnings of $300,000 by lessee company would pay out in 4 years and 2 months.

Payment in first year must not be in excess of 30% of sales price, or $300,000, to qualify sale as an installment payment transaction.

220 EARNINGS PER ANNUM OF LESSEE OPERATING COMPANY

(Assumed Capital $50,000)

Net before rent and taxes	$300,000
Rent	240,000
Retained	$ 60,000
5 year's net earnings before taxes	$300,000
Assume average 50% taxes on $60,000 per annum	150,000
Balance	$150,000
Long term capital gain tax when lessee corporation dissolved	37,500
Net gain after capital gains tax in 5 years	$112,500

450% earned on $25,000 capital in 5 years
90% earned on $25,000 capital annually

Net gain after taxes in next 5 years on basis of rental reduced to 60% of net earnings	$225,000
Net gain for 10 years	$337,500

1350% earned on capital in 10 years
135% average earnings on capital annually

(The above calculated gain is in addition to salaries paid to managers of lessee company.)

221 ASSUMED STATUS OF SELLERS

Sales Price of stock of company	$1,000,000
Cost	400,000
Profit	$ 600,000
Long Term capital gain tax	150,000
Net profit after taxes	$ 450,000
5 year net earnings after taxes on 45% of stock of new lessee companies when dissolved (assuming $300,000 net earnings per annum)	50,625
	$ 500,625
Second 5 year net of lessee company	$ 101,250
Net gain after taxes	* $ 601,875
Add back cost of property	400,000
	$1,001,875

(* Not including salaries and expense reimbursement)

222 PRO-TEM INITIAL STATEMENT OF NEW LESSEE CORPORATION, AFTER ACQUISITION FROM INSTITUTE OF CURRENT POSITION OF OLD OPERATING COMPANY

ASSETS

Current Assets:

Cash	$ 25,000
Receivables	250,000
Inventory	525,000
Total Assets	$800,000

LIABILITIES	
Current Liabilities:	
Accounts Payable	$300,000
5-year note to Institute for current position	475,000
Capital	25,000
Total	$800,000

223 **Exhibit 25-Y**

(Received Dec. 18, 1952. Clay Brown & Company)

MAdison 6-1381

LOUIS H. SEAGRAVE
840 General Petroleum Building
612 South Flower Street
Los Angeles 17, California

December 17, 1952

Mr. Clay Brown
President
Clay Brown & Co.
U. S. National Bank Bldg.
Portland 4, Oregon

Dear Mr. Brown:

During the past week I have gone over my notes and papers you supplied me, and talked with some of the officers of the California Institute for Cancer Research.

All of us are impressed with your company and the kind of management you are giving it. We would like very much to see it acquired by the Institute.

Our difficulty is the price, or to put it another way, we feel that a $250,000 premium over reconstructed values is perhaps all a purchase will stand, especially since average earnings before taxes of $360,000 would be required to pay off a price of $1,300,000. Earnings of $360,000 per annum are a little higher than your own idea of $350,000. Incidentally, earnings before taxes for the two and one-half years to October 31, 1952 averaged about $300,000 per anuum, but if we were to add back to the year ended April 30, 1952 the amount of $150,000, which would prob-

ably not be far from the amounts charged to expense for items which could have been capitalized, and assume net earnings for the current year would aggregate $350,000 the three-year average would be about $350,000.

On the other hand, there is another angle not to be overlooked, namely, the prospective earnings of the new lessee company, in which stockholders of the present company could own nearly 50%. Assuming net before taxes of $350,000, earnings per annum of the new company after payment of rental would be $72,000. Assuming that income taxes for such an amount of earnings average 33 1/3%, the net to surplus would be $48,000 a year or $240,000 for the five years period.

224 The net equity accruing to the 49% interest in the new lessee company would amount to $117,000 additional. This would increase the total proceeds of the sale to $1,417,000, which is the equivalent of $44.28 a share.

So far as I know, the Internal Revenue Department has never objected to ownership by the sellers and their families of a *minority* interest in the new lessee company. Our counsel, Paul R. Coté, who was the lawyer who originated the formula we follow in such purchases, says that a minority interest cannot, under the statutes and tax rulings, be regarded as control, and hence cannot be the base for an attack on the theory that the seller is "doing business with himself." Always providing, of course, that neither the sellers or members of any of their families, are directors or statutory officers of the new lessee company.

If your counsel has reservations about this, I wish he would talk to Paul R. Coté, or write to him. His phone numbers are Bradshaw 25177 (Los Angeles exchange) and Crestview 13146 (Beverly Hills exchange). His address is 118 S. Beverly Drive, Beverly Hills.

We've given a good deal of thought to the possibility of making a purchase of timberland and stumpage, which Clay Brown & Co. contracted to cut and process over a period of years. Not only would it apparently be a good protection to you, but should result in substantial profits. A certain source of, say, half of your logs each year would enhance our ideas of the value and payout of purchase of Clay Brown & Co.

If you carry out your intention of returning to Eureka December 22nd for the Christmas holidays, I profoundly hope you will find an opportunity of pressing that phase of the matter.

My best regards.

Sincerely yours,

(Signed) L. H. Seagrave

LHS:HL

225 **Exhibit 26-Z**

(Received Dec. 19, 1952. Clay Brown & Company)

MAdison 6-1381

LOUIS H. SEAGRAVE
840 General Petroleum Building
612 South Flower Street
Los Angeles 17, California

December 17, 1952

Mr. Clay Brown
President
Clay Brown & Co.
U. S. National Bank Bldg.
Portland 4, Oregon

Dear Mr. Brown:

We would appreciate your having a copy sent me of your complete audited statement for April 30, 1952. As you may remember, we have only the balance sheet and profit and loss statement for that date.

Would you also ask Mr. Booth to make up for us a pro-forma balance sheet for October 31, 1952, substituting the values we talked about. I think he said that his calculation gave a net worth of about $1,050,000 based on appraisals and other items, whereas I got only $1,000,000. I know I overlooked something, and the easiest way to get it right would be to use the same figures he has; marginal notes or a list showing the additional items and amounts would also be helpful.

Sincerely,

(Signed) L. H. Seagrave

LHS:HL

December 22, 1952

Mr. Louis H. Seagrave
840 General Petroleum Building
612 South Flower Street
Los Angeles 17, California

Dear Mr. Seagrave:

Mr. Brown has left for the mill and before going he handed me your letter of December 17th, asking that I compile and send the information requested.

Under separate cover I am sending you a signed audited statement prepared by Peat, Marwick, Mitchell & Co. dated April 30, 1952. This accounting firm made a complete audit including inventory observation as of April 30, 1952 but prepared only the short form of statement enclosed. We requested that they prepare only this abbreviated form since it would be less expense for us and we felt this would take care of our requirements. Should you require supplemental detail for this same period, we can submit it to you unaudited from our own work sheets and would be glad to do so. Our monthly statements regularly include, in addition to the statement of income and the balance sheet, the following:

Statement of Cost to Manufacture
Detail of Direct Charges and Mill Overhead
Summary of Direct Charges and Mill Overhead
Summary of Selling and Administrative Expenses
Accounts Receivable
Accounts Payable

If you wish any of the above supplemental sheets as of April 30, 1952, please advise and we will send them to you promptly.

I am now in the process of compiling information and preparing a pro forma balance sheet as of October 31, 1952 substituting the revised values. Quite likely this will be in the mail to you be tomorrow.

Mr. Brown requested that I ask you if you would be willing to supply us with the names of any other firms with whom the Institute has completed negotiations such

as we are currently considering. We, of course, are
227 familiar with the Timber Structures deal but are wondering if there are others which were consummated somewhat earlier and which perhaps by now have been examined by the Internal Revenue Bureau. If so, we would like the opportunity of talking with the principals of such companies and this would be especially helpful if they happen to be in the lumber or wood products industry.

I understand that our attorney, Mr. Souther, planned to talk to Mr. Coté today although I have not yet heard whether the call was completed and if so what information Mr. Souther gleaned from the conversation.

Yours truly,

CLAY BROWN & COMPANY
C. W. Booth
Secretary-Treasurer

CWB/bs
cc:CB

228 (Received Jan. 8, 1953. Clay Brown & Company)

MAdison 6-1381

LOUIS H. SEAGRAVE
840 General Petroleum Building
612 South Flower Street
Los Angeles 17, California

January 7, 1953

Mr. C. W. Booth
Secretary-Treasurer
Clay Brown & Company
U. S. National Bank Bldg.
Portland 4, Oregon

Dear Mr. Booth:

I am sorry to be so long in answering your letter of December 22nd but the holidays and several absences from the city put me a long way behind in my correspondence.

First of all I received the audited statement of Peat, Marwick, Mitchell & Co., dated April 30, 1952, for which I thank you. I should like, also, to have the supplemental

details for that same date in the unaudited form, including the six schedules you mentioned in your letter of December 22nd, which you kindly volunteered to send me.

The ProForma Statement of Assets of October 31, 1952, in which the revised values were substituted, and the itemized schedule B, which makes the substitutions entirely clear, were also received and very much appreciated.

As to companies with which deals have been completed, my suggestion is that the one of most interest to you would be that of the White Pine Lumber Company in Reno, Nevada, which was sold to Loyola University and handled by Paul Coté. Probably you or Mr. Brown know the principals connected with that company.

Another suggestion is the name of Dana Latham, a leading tax attorney in Los Angeles, whose present offices are in the Statler Building, 900 Wilshire Blvd.,
229 Los Angeles. He has been familiar with this type of transaction for a good many years, and I believe, with Mr. Coté handled the sale of the U. S. Grant Hotel, as well as the more recent sale of the Allied Recorder Company. He is also counsel for another company, the name of which I am not yet free to give you but it may be that you or your lawyers would like to contact him and ask him a few questions. I understand from Mr. Coté that Mr. Souther did talk to him, in particular concerning the ownership of a new operating company.

I am of the opinion that it would be, as you suggest, a good idea to bring the appraisal up to date, if we arrange a basis for a deal. I hope it will not be too expensive. Thank you very much for your careful attention to my requests.

I will not be in the office after Friday, and will be in Portland the fore part of next week, so you may as well hold the supplementary sheets to your company statement of April 30, 1952, and hand them to me when we meet in Portland.

You probably now have the company statement for November 30th and may have some preliminary idea of results for December. These figures, of course, I would like to know though I realize that these months, and Decem-

ber in particular, are off-season and that the earnings for this half year will probably occur in the first four months of this fiscal year.

Kindest regards.

Sincerely yours,

(Signed) L. H. Seagrave

LHS:HL
cc: Mr. Clay Brown

Exhibit 28-BB

230

December 23, 1952

AIR MAIL.
Mr. Louis H. Seagrave
840 General Petroleum Building
612 South Flower Street
Los Angeles 17, California

Dear Mr. Seagrave:

We attach hereto two schedules—the first, a statement of assets showing adjusted values as of October 31, 1952 and the second, which we have labeled "Schedule B", showing how we have arrived at these values.

You will note the adjusted fixed assets amount to $1,005,068 and in addition there is an item of $25,000 consisting of supplies which we have included in the current assets, making a total adjusted value of $1,030,000. We have not prepared a liability side of the October adjusted balance sheet since the only changes would be in the earned surplus and the accrual for income and excise taxes. It is difficult, if not impossible, to determine just what portion of the $423,750 should be allocated to each of those two accounts.

In preparing Schedule B we started with the appraisal prepared by General Appraisal Company in July, 1951 and Mr. Brown tells me you have the recapitulation from the mill copy of this appraisal so that you can readily identify the first column of figures. In the second column of figures we have reduced two items since the General Appraisal Company included among our assets a crane and some fork lift trucks and straddle carriers which the company leases and does not own.

As we mentioned to you over the telephone, the appraisal did not include land value; and a further analysis reveals the appraisal does not include a logging arch which was working in our timber at the time the appraisal was taken and apparently was overlooked. In addition there are four executive automobiles plus some trucks and a station wagon which were not listed in the appraisal; nor did the appraised figures include furniture and fixtures and office equipment in Portland and San Francisco and in our Eureka apartment.

The third column lists items which were expensed in our books but which added to the value of the properties. You will note this column totals $63,000 which is approximately the figure that you and Mr. Brown and Mr. Hill agreed was reasonable for lumber, labor and other expensed items when you discussed this feature at our mill. The total indicated here is approximately $20,000 less
231 than the $1,050,000 we indicated in our telephone conversation, and the original figure was based on calculations made rather hurriedly. Even so, we feel that the figure herein presented is conservative and a revised appraisal might easily bring this up to or beyond the $1,050,000 figure we gave you on the telephone. We should think that it might be worthwhile to bring the appraisal up-to-date although, of course, there would be some expense involved in doing this.

We hope this gives you the information you need; but if you should require anything further or a more detailed explanation of any of the items listed, please let us know and we will attempt to get you whatever you need.

Yours truly,

CLAY BROWN & COMPANY
C. W. Booth
Secretary-Treasurer

CWB:bs
cc:CB
Enc.

	Per Statement Oct. 31, 1952		Estimated Increases in Value		Adjusted Values Oct. 31, 1952	
Cash		$ 9,364				$ 9,364
Accounts & Notes Receivable, less allowance for doubtful accounts:						
Trade (less freight)	$173,459					
Sundry & Notes Receivable	2,390					
	175,849					169,758
Allowance for doubtful accounts	6,091	169,758				
Inventories:						
Logs	538,353					
Lumber	60,607					
Supplies	—	598,960		$ 25,000		623,960
Prepaid Expenses:						
Falling & Bucking	1,606					
Insurance	11,088	12,694		—		12,694
TOTAL CURRENT ASSETS		790,776		25,000		815,776
Property, Plant & Equipment:						
Land	24,635		$ 38,935		$ 63,570	
Buildings, Equipment & Facilities, Automotive, Yard & Logging Equipment, Furniture & Fixtures	613,566		182,827		796,393	
Total Fortuna Plant	638,201		221,762		859,963	
Sales & Executive Offices:						
Automobiles	13,015		(3,015)		10,000	
Furniture & Fixtures	7,376		4,729		12,105	
	658,592		223,476		882,068	
Less allowance for depreciation	103,201		103,201			
	555,391		326,677		882,068	
Timber, less depletion	50,927	606,318	72,073	398,750	123,000	1,[illegible],068
Deposits & Deferred Charges to Operation		4,188				4,188
		$1,401,282		$423,750		$1,825,032

SCHEDULE "B"

233

	Value per Appraisal July, 1951	Plus items Capitalized since July, 1951 or not included in appraisal	Plus items expensed	Total Value
Mill "A"—Construction	$ 33,995		$ 1,038	
Mill "A"—Equipment	138,386	$ 25,451		
Resaw & Green Chain extension		4,386	16,255	
Sprinkler system		2,867		$ 222,37
Mill "B"—Construction	39,240	253		
Mill "B"—Equipment	117,418			
Paint & Painting		2,213	1,028	
Band Mill & Filing Room		4,625	5,000	169,77
Planing Mill—Construction	13,236		142	
Planing Mill—Equipment	61,449			74,82
Shop—Construction	5,898			
Shop—Equipment	6,556	591 (a)		13,04
Carrier Garage—Construction	4,540		4,600 (b)	
Carrier Garage—Equipment	36,810	(28,250) (c)		
Trucks and Station Wagon		7,000 (c)		24,70
Trim Saw Shed—Construction			2,500 (d)	2,50
Drag Saw & Tool Sheds, Oil & Store house & Power service shed:				
Construction	3,151			
Equipment	8,413			11,56
Toilets—Construction	746		960 (e)	
Toilets—Equipment	11		1,116 (e)	2,83
Log Scaler & Unloader sheds—Construction	757			
Log Scaler & Unloader sheds—Equipment	2,549		4,801 (f)	8,10
Log Scaler platforms & shack				
Fire pump house—Construction	4,478			
Fire pump house—Equipment	16,501			
Pump & Hose Houses—Construction	1,252			27,64
Pump & Hose Houses—Equipment	5,375			
Office—Construction	15,126			20,77
Office—Equipment	5,648			
Yard—Construction	12,991		5,712 (g)	
Yard—Equipment	172,931	(43,350) (h)		150,19
Concrete at load dock & chains			1,911 (i)	15,00
Sundry lumber, labor & other items			15,000 (j)	53,08
Pond—Construction	53,088			63,57
Land—42.38 Acres @ $1500		63,570		
Furniture & Fixtures—Portland, San Francisco & Eureka		9,104 (k)	3,000	12,70
4 Automobiles at estimated present value		10,000		10,00
Timber—15MM @ $8.20		123,000		123,00
	$760,545	$181,460	$63,063	$1,005,06

SCHEDULE "B" Continued

(a) Steam cleaning outfit.

(b) Garage was doubled in size after date of appraisal.

(c) Appraisal included lift trucks and lumber carriers not owned by Clay Brown & Company but leased, and did not include dump truck, two pickup trucks and a station wagon which were owned.

(d) New since appraisal.

(e) Two new toilets with septic tanks built recently.

(f) New since appraisal.

(g) Gravel for yard and dikes; raising spur track and additions to fences and auto gate.

(h) Appraisal included Osgood Crane not owned but leased. Did not include logging arch owned and valued at $4000.

(i) Concrete at loading dock and around sorting chains.

(j) Mostly applicable to sawmill buildings.

(k) At book value 11/30/52.

EXHIBIT
31-EE

APPRAISEMENT

of

[redacted]

Located at

[redacted]

by

General Appraisal Company

Incorporated

Valuation Engineers

SAN FRANCISCO
74 NEW MONTGOMERY ST.

SEATTLE
408 MARION ST.

LOS ANGELES
208 WEST EIGHTH ST.

PORTLAND
TERMINAL SALES BLDG.

236 INTRODUCTION

Portland, Oregon
January 14, 1953

Clay Brown & Company
Fortuna, California

Gentlemen:

In accordance with your instructions, we herewith present our Summary Appraisement, as of the above date, of certain physical assets as follows:

Clay Brown & Company
Fortuna, California

This summary is based upon an itemized detailed appraisal as of the date of July 21st., 1951. Percentage of increase in market values and depreciation to the present date have been taken into consideration in preparing this report. The various items herein valued have been pointed out to us as your property and the question of "title" to these items has not been included in our investigation.

Itemized details of this appraisement are on file, subject to owners directions, at the office of the General Appraisal Company, 209 Terminal Sales Bldg., Portland, Oregon.

The Preface to the appraisement immediately following outlines the method of procedure and the basis of valuation. It has been a pleasure to be of service to you in this matter.

Very truly yours,

GENERAL APPRAISAL COMPANY
By Roy A. Dean, President

237 PREFACE TO APPRAISEMENT

Listing Method

The detailed information contained in this report has been obtained by a personal inspection of the subject property. Where buildings, tenants' improvements, or other items of construction are involved, the component parts have been listed in detail and segregated according to standard construction classifications. Where machinery

and equipment are involved, an item-by-item listing has been completed. Arrangement is by appropriate classification, location or department. Installation, belting, piping, wiring, millwrighting and other appurtenant items have been listed with each machine or classification. This listing method facilitates the ready determination of the value of each machine or production unit.

New Replacement Value

New replacement cost of the various items of construction and equipment has been determined as of the date of this appraisement on the assumed basis of replacing the entire property as a complete unit at one time. In determining the reproduction cost of each item of construction and equipment we have used current local prices including freight and cartage, applicable labor rates for a 40-hour week, normal contractor's profit and overhead, architectural and engineering costs, contingent costs, insurance and other indirect costs incidental to actual construction of the building or installation of equipment as appropriate. It has been assumed that suitable materials are available and can be delivered without unusual delay. No allowance has been made for unusual labor overtime or inefficiency, nor for change orders during construction or installation.

Depreciated Value

Depreciated value, or in insurance terms "actual cash value," represents the present value as judged by a comparison of actual physical condition and currency of each item or unit with new items or units of like kind and quality. The depreciated value of any item may be defined as the remaining service value plus the salvage value. Depreciated value also reflects factors such as obsolescence, supersession, maintenance, and lack of utility. Depreciation may be offset in part by the renewal of parts or by partial reconstruction. Depreciated value represents our opinion of the value of such property predicated upon the assumption that it is operated under competent management by a profitable going concern.

238 Clay Brown & Co.

RECAPITULATION

January —, 1953

	New Replacement Value	Depreciated Value	Excluded Value	Insurable Value
Saw Mill "A"				
Construction	35,850.83	32,229.41	2,665.55	29,563.86
Equipment	172,389.51	145,726.02	2,431.29	143,294.73
Mill "A" Sorting Shed				
Construction	8,764.61	7,916.51	233.66	7,682.85
Equipment	18,226.20	16,042.62	109.27	15,933.35
Saw Mill B				
Construction	46,307.43	42,866.80	2,284.98	40,581.82
Equipment	146,236.18	121,513.54	424.74	121,088.80
Mill B Sorting Shed				
Construction	4,413.09	4,063.31	90.80	3,972.51
Equipment	5,466.90	4,922.66		4,922.66
Planing Mill				
Construction	15,239.54	13,912.78	869.33	13,043.45
Equipment	63,415.33	49,452.50	179.19	49,273.31
Misc. Bldgs.				
Shop				
Construction	6,282.86	5,787.16	566.92	5,220.24
Equipment	7,958.08	5,761.07		5,761.07
Carrier Garage				
Construction	4,720.45	4,339.60	598.64	3,740.96
Equipment	7,904.97	3,826.10	+ 3,594.50	3,826.10
Saw Shed				
Construction	1,428.76	1,357.33		1,357.33
Equipment	1,212.20	969.76		969.76
239				
Drag Saw Shed				
Construction	864.92	648.70		648.70
Equipment	1,211.84	959.44		959.44
Toilets #1 & #2				
Construction	1,596.48	1,396.92		1,396.92
Equipment	10.94	7.66		7.66
Oil House				
Construction	1,143.59	1,029.23	100.21	929.02
Equipment	111.05	94.39		94.39
Power Service Shed				
Construction	990.99	891.89	93.74	798.15
Equipment	6,991.08	6,152.15		6,152.15
Tool Shed				
Construction	203.65	173.10		173.10
Equipment	171.56	128.67		128.67
Store House				
Construction	168.45	143.19		143.19
Log Scaler Shed				
Construction	527.48	395.61		395.61
Equipment	89.01	66.76		66.76

RECAPITULATION, Cont'd.

	New Replacement Value	Depreciated Value	Excluded Value	Insurable Value
Misc. Bldgs. Cont'd.				
Log Unloader Shed				
Construction	282.93	226.35		226.35
Equipment	2,597.28	1,947.96		1,947.96
Pump House #1				
Construction	218.01	196.21		196.21
Equipment	1,872.61	1,647.89		1,647.89
240				
Pump House #2				
Construction	218.01	196.21		196.21
Equipment	1,872.61	1,647.89		1,647.89
Pump House #3				
Construction	286.53	272.21	3.94	268.27
Equipment	589.01	559.55		559.55
Fire Pump House				
Construction	4,638.68	4,431.85	779.75	3,652.10
Equipment	17,084.61	15,316.86	357.62	14,959.24
Hose House #1				
Construction	141.45	124.48		124.48
Equipment	164.83	145.05		145.05
Hose House #2				
Construction	141.45	124.48		124.48
Equipment	314.58	289.42		289.42
Hose House #3				
Construction	141.45	124.48		124.48
Equipment	402.46	370.26		370.26
Hose House #4				
Construction	141.45	134.38		134.38
Equipment	152.54	141.86		141.86
Hose House #5				
Construction	48.87	43.01		43.01
Equipment	291.34	268.04		268.04
241				
Office				
Construction	15,942.83	14,565.14	370.66	14,194.48
Equipment	6,137.91	5,329.14		5,329.14
Yard				
Construction	13,511.28	10,975.76	+ 1,779.06	8,734.97
Equipment	156,581.28	118,643.81	{ 2,238.79 / 50,698.13 }	67,950.66
Pond			+ { 35,293.70 }	
Construction	53,088.45	53,021.71	52,790.05	231.66
Arch (listed as crane)			3,191.32	
Total Construction	217,304.52	201,587.81	63,687.02	137,900.79
Total Equipment	619,454.91	501,936.07	54,200.24	447,735.83
Total addn's to exclusions			add 41,265.90	less 41,265.90
Grand Totals	836,759.43	703,523.88	159,153.16	544,370.72

242 Exhibit 32-FF

PURCHASE AGREEMENT

This Purchase Agreement, made and entered into at Portland, Oregon, this 4th day of February, 1953, by and between Clay Brown of Portland, Oregon, acting for and on behalf of himself and all of the other stockholders of Clay Brown & Co., an Oregon Corporation, namely: Dorothy E. Brown; Donald Brown; Philip Brown; Marilyn Brown; C. A. Hill; Nancy H. Booth and C. W. Booth; hereinafter referred to as "Seller", and California Institute for Cancer Research, a California non-profit corporation, hereinafter referred to as "Buyer":

WITNESSETH:

That for and in consideration of their respective agreements hereinafter set forth, Seller and Buyer hereby agree, each with the other as follows:

I.

That as of the date of this agreement, Seller has sold, assigned, transferred, and delivered to and does hereby sell, assign, transfer and deliver to Buyer all, to-wit: 32,000 shares of the issued and outstanding capital stock of Clay Brown & Company, an Oregon corporation, hereinafter referred to as "Brown & Co." Seller has likewise sold, assigned, transferred and delivered, and does hereby sell, assign, transfer and deliver, without recourse, to the Buyer, two (2) promissory notes owned by Clay and Dorothy E. Brown and executed by Brown & Co., the total principal amount of said promissory notes being $125,000.00 (which notes shall hereinafter be referred to as the Brown notes). Clay and Dorothy E. Brown agree to waive any interest that may accrue on the Brown notes subsequent to the date of this agreement.

II.

The purchase price of said stock and notes re-
243 ferred to in paragraph I above which Buyer shall pay to Seller in the manner and at the times and from the sources hereinafter set forth, is $1,300,000.00, subject to revision as hereinafter provided in paragraphs III and XX. Said purchase price shall be evidenced by a non-negotiable promissory note, subject to payment as

herein provided for, in the amount of $1,300,000.00, without interest, signed by the Buyer (which note shall hereinafter be referred to as the principal note).

III.

An audit of the books, records and accounts of Brown & Co. will be prepared by Seller's accountants, Peat, Marwick, Mitchell & Company of Portland, Oregon, as of the close of business on January 31, 1953 (hereinafter referred to as the 1953 audit), and said audit shall be subject to the approval of Buyer or any Certified Public Accountant selected by Buyer. Seller, concurrently herewith, has furnished to Buyer a balance sheet and profit and loss statement for Brown & Co. as of October 31, 1952, and Seller warrants and represents that said Balance Sheet and Profit and Loss Statement so furnished accurately reflect the financial condition of Brown & Co. at the date of this agreement, except as to such changes therein as have resulted from the normal and usual operation of the business of Brown & Co. from the first day of November, 1952, to the date of this Agreement, and that said audit to be prepared by Peat, Marwick, Mitchell & Company will reflect only such changes. If for any reason it should become necessary to set up a tax reserve in excess of the amount of tax reserve set up in the certified audit, then the excess of said reserve shall result in a reduction of the principal note by the amount of such excess. Neither the statement dated October 31, 1952, nor the audit prepared as of the close of business on January 31, 1953, shall show or reflect any reserve for re-negotiation. If, in the future, any liability should be established by reason of re-negotiation on any contract previously entered into by Brown & Co. which is subject to re-negotiation under the provisions of the Federal law, then and in said event, the amount of such liability resulting from said re-negotiations, and which affect profits earned prior to January 31, 1953, will likewise reduce the amount of the principal note as set forth in paragraph II of this agreement.

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IV.

Buyer shall liquidate and dissolve Brown & Co. forthwith upon the delivery of said shares of stock by Seller

to Buyer, and all of the assets of Brown & Co. shall be distributed in liquidation to Buyer as a liquidating dividend.

V.

Buyer, immediately upon liquidation and distribution of the assets of Brown & Co. shall:

(a) Pay $5,000.00 in cash to Seller upon the principal note; and

(b) Execute a lease and license agreement (hereinafter referred to as the lease) with Fortuna Sawmills, Inc. (hereinafter referred to as Lessee), which lease shall license and lease to Lessee the name, good will, patents, patent applications, trademarks and all of the fixed assets received by Buyer from the liquidation of Brown & Co. upon the terms and conditions set forth in Exhibit "A" attached hereto and made a part hereof by reference; in the event the lease shall for any reason terminate Buyer shall use its best efforts to forthwith re-lease and re-license the property to a new lessee under a similar lease and the term "lease" used herein refers also to such subsequent lease, if any; and

(c) Sell to Lessee all of the assets received by Buyer upon the liquidation of Brown & Co., excepting the sum of $5,000.00 in cash and the assets described in the lease, upon the following conditions:

Lessee shall agree in writing to assume, and pay when due, out of the assets so purchased, all of the current and deferred expenses, obligations, and liabilities of Brown & Co., as shown on the 1953 audit, excepting the Brown notes; and

Said written assumption agreement of the Lessee
245 shall also provide for the payment by Lessee to the Buyer out of the assets so purchased of the amount by which the total amount of the assets so purchased exceeds the total liabilities and obligations so assumed; and this obligation of the Lessee to pay such excess shall be evidenced by a promissory note due and payable on or before five years from the date of this agreement, without interest, but with an acceleration clause in event payor defaults in the payment of any of said liabilities assumed by Lessee as above set forth (which promissory note shall hereinafter be referred to as the purchase note). The

assets so purchased shall be sold at the book value thereof as disclosed by the 1953 audit. In event that it shall become necessary for the Lessee to obtain independent financing or credit, and in order to do so, it shall be required to obtain the subordination of the purchase note to said financing or credit, then Buyer agrees to so subordinate the purchase note.

VI.

Buyer shall pay to Seller ninety (90%) per cent of all royalties or rents received in cash by Buyer from the Lessee under the lease until the remaining balance of the principal note has been paid in full; provided, however, that the entire balance of the principal note, if not sooner paid, shall be due and payable on the 31st day of January, 1963. The unpaid balance of the principal note shall bear no interest until maturity, but thereafter shall bear interest at the rate of five (5%) per cent per annum.

VII.

Seller shall have the right, at his option, to accelerate the entire unpaid balance of the principal note in the event that the Buyer shall fail to pay the Seller a total of Two Hundred Fifty Thousand Dollars ($250,000.00) during any two consecutive years of the term of the lease. For the sole purpose of determining whether the right to accelerate exists under the preceding paragraph, there
246 shall be added to the cash amounts so paid, the aggregate amounts incurred for capital improvements or additions in said two consecutive lease years with the prior written consent of the Buyer.

VIII.

Buyer shall be obligated to make payment of the principal note only out of 90% of the royalties and rental received by Buyer from the Lessee under the lease and out of the proceeds from sales, if any, of the assets leased or licensed to the Lessee as hereinafter permitted.

IX.

In event that either Buyer or Lessee shall use all or any of Lessee's profits or the rental or royalty paid to Buyer under the lease, to pay any liability or obligation of Brown & Company as disclosed by the 1953 audit, or

any liability covered under the Indemnity Agreement of Seller under paragraph XX of this Agreement, they or any of them shall be entitled to do so, and any such application by Lessee out of Lessee's profits or by the Buyer out of said rental or royalty, shall not be a default by the Lessee under said lease, or by the Buyer in its obligations hereunder, or under the principal note; and if the amount so used is used to pay liabilities or obligations as disclosed on said 1953 audit, the amount shall not be applied on the principal note; but if the amount so used is applied on any liability covered under Indemnity Agreement of Seller under paragraph XX of this agreement, then the amount so used shall be applied on the principal note.

X.

The sale of all or any of the assets (other than fixed assets) by Buyer to the Lessee is hereby approved by Seller on condition that the full proceeds representing the excess of the assets so sold over the obligations or liabilities of Brown & Co. assumed by the Lessee will be paid by Buyer to Seller within five (5) days after
247 receipt thereof in cash by Buyer from the Lessee and shall be applied by Seller upon the principal note.

Buyer shall not be deemed to have received payment from the Lessee until said payment is received in cash. The acceptance of a note or notes evidencing said indebtedness of the Lessee for the purchase price of such assets shall not be deemed to be a payment of the amount thereof to Buyer, but any such note or notes shall be assigned by Buyer to Seller as additional security for the payment by Buyer of the principal note.

XI.

No sale by Buyer of any assets received by Buyer on dissolution of Brown & Co., other than those sold to the Lessee pursuant to the provisions of paragraph IX above shall be effected without the prior written consent of Seller theretofore having been first had and obtained.

XII.

In the event that Buyer shall default in any of the obligations under the provisions of this agreement, Seller may, at his option, and without notice or demand to Buyer,

declare the entire remaining balance of the principal note immediately due and payable, and if such balance is not so paid, Seller may proceed to enforce payment against the collateral held by Seller as security, but out of said collateral only.

XIII.

All payments made by the Buyer to Seller shall apply, first: seventy-five (75%) per cent on the purchase price of the Brown notes, which purchase price for the Brown notes shall be deemed and considered as the face amount thereof; and twenty-five (25%) per cent on the purchase price of said stock. Upon the payment in full of the Brown notes, then all payments made by the Buyer to Seller shall apply on the purchase price of the stock.

XIV.

Concurrently with the execution of this agreement
248 and the liquidation of Brown & Co. and the acquisition of the assets of Brown & Co. by Buyer upon liquidation, and also upon the acquisition of any additional fixed assets as herein provided, Buyer shall execute and deliver to Seller, properly executed to permit recordation thereof, a real estate mortgage or deed of trust on any real property, and a chattel mortgage on any personal property, acquired by Buyer upon the liquidation of Brown & Co., (except assets sold to the Lessee), and an assignment of the lease and the purchase note, to secure the payment by Buyer to Seller of the principal note at the time and in the manner herein required, and shall further execute and deliver a real property mortgage or deed of trust of any real property and a chattel mortgage of any personal property acquired by Buyer at any time as the result of this transaction, or the provisions of the lease as further security to Seller for the payment of the principal note.

Inasmuch as patents and patent applications and trademarks are not subject to chattel mortgage, Buyer agrees to assign said patents, patent applications and trademarks to Seller to further secure the unpaid balance of the principal note and said assignments shall be deemed and considered as defeasible assignments in the same manner as a chattel mortgage so that, upon the payment in full of the unpaid balance of the principal note by Buyer to

Seller, said patents, patent applications and trademarks shall be re-assigned by Seller to Buyer.

XV.

The payments to be made by Buyer to Seller out of rental as herein provided shall be so made within five (5) days after receipt by Buyer of each payment of such rental from the Lessee, and the payments to be made by Buyer to Seller out of the sale of any assets shall be so made within five (5) days after the receipt by Buyer in cash of the proceeds of the sale of any such assets.

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XVI.

For the purposes of this agreement, it is mutually understood and agreed that the words "net profits" upon which the rental to be received by Buyer from the Lessee is based, shall be construed to mean net profits before depreciation and before provision or deduction for income, franchise, excess-profits, or other similar taxes, computed in accordance with sound accounting practices by public accountants mutually acceptable to Buyer and Seller.

XVII.

At the time of the making of each payment to apply on the principal note, Buyer shall deliver to Seller the following documents appropriate thereto:

(a) A detailed statement of the amount of gross rental received by Buyer from the Lessee; and

(b) A detailed statement of the gross selling price, the expenses of sale, and the net proceeds of sale received by Buyer from the sale of assets determined on the basis provided in this agreement.

XVIII.

Buyer covenants and agrees to keep full, accurate and complete records reflecting all of the rental and proceeds from the sale of assets received by it until such time as the principal note has been paid in full to Seller. Said records and accounts, and all vouchers and statements upon which the same are predicated, shall at all times be subject and open to the inspection of said examination by Seller or his agent or representative.

XIX.

Seller, in addition to its representations and warranties as hereinabove set forth in reference to said audit to be prepared by Peat, Marwick, Mitchell & Company, hereby make the following representations and warranties and no others in connection with the purchase and sale of the assets and notes which are the subject of this purchase agreement.

(a) That Clay Brown & Company is a corporation duly organized and existing under and by virtue of the laws of the State of Oregon, and is duly qualified and is transacting business in the States of California and Oregon; that there is now issued and outstanding 32,000 shares, and no more, of the capital stock of said corporation; that said shares have a par value of $1.00 each; that all of said shares issued and outstanding are valid and were regularly and validly issued under and in compliance with the laws of the State of Oregon; that Seller has full right and authority to sell and transfer all of said shares purchased by Seller under this agreement; that all of said shares purchased by Buyer under this agreement are free and clear of all liens, encumbrances, obligations or pledges, and that no other persons have any right, title or interest in said stock other than Seller.

(b) That there will be attached hereto marked Exhibit "B" and by this reference made a part hereof, a Balance Sheet of Brown & Co. as of the close of business on January 31, 1953, prepared by Peat, Marwick, Mitchell & Company, which shall be a part of the audit as provided for in paragraph III above; that said Balance Sheet will accurately reflect the financial condition and net worth of Brown & Co. as of said date, and will correctly set forth all obligations and liabilitiles of Brown & Co. existing as of said date, and of whatever nature, contingent or otherwise, and either directly or by way lar taxes levied or assessed, or accrued, on or before the date of said Balance Sheet; that all of Brown & Co.'s franchise taxes, federal income and excess profits tax, social security and unemployment taxes, and retail sales and use taxes, and federal withholding taxes to and including the date of said Balance Sheet have been paid or

accrued, and if accrued, set forth on said Balance
251 Sheet; that Seller does not know of any taxes, liabilities, or assessments, whether or not assessments thereof have as yet been made, or any litigation not reported or shown on said Balance Sheet, and does not know of any ground upon which any deficiency taxes, assessments, penalties, or interest might be made, and does not know of any other claim, obligation or liability of Brown & Co. not shown on said Balance Sheet which may be assessed against Brown & Co., or which may result in litigation; that no litigation is now pending by or against Brown & Co. except as may be shown on said Balance Sheet; that said Balance Sheet to be prepared by Peat, Marwick, Mitchell & Company will reflect only such additional changes over the Balance Sheet of said corporation as of October 31, 1952, as may result from the normal and usual operation of business of Brown & Co.; that there are no leases or executory contracts of any kind or nature upon which Brown & Co. could have any liability except those shown on said Balance Sheet.

XX.

Seller agrees with Buyer, and for the benefit of Brown & Co., and the directors of Brown & Co. at the time of dissolution of Brown & Co. (which directors shall hereinafter be referred to as directors) that Seller shall and does hereby indemnify, save and hold harmless Buyer, Brown & Co., and directors of and from any assessment, taxes, penalties, interest, or liabilities of any kind or nature that may be levied or assess against or may be found to be due and owing from Brown & Co. excepting such as are shown in said Exhibit "B." Seller reserves the right to defend Buyer, Brown & Co. or directors at Seller's own expense against any taxes or other liability or other obligation covered by this Indemnity Agreement of Seller, but Buyer may, at Buyer's option, charge any unpaid liability of Seller, under this paragraph XX against any balance due Seller on said promissory notes. Seller's Indemnity Agreement shall likewise cover all losses, costs,
liabilities or expenses of Buyer, Brown & Co. or di-
252 rectors. Seller shall be notified promptly in writing of any claim for any such taxes, liabilities or obligations covered by Seller's indemnity which may be asserted

hereafter against either Buyer, Brown & Co. or directors. Nothing herein contained, however, shall be deemed or considered as affecting the provisions as to reserve for taxes, or re-negotiations as hereinabove set forth in paragraph III above, and any such increase in income or excess profits taxes or liabilities or re-negotiations shall not be deemed or considered under the personal warranty of the Seller, but shall effect only the purchase price as recited in said paragraph III.

XXI.

Any and all notices which Buyer may be required or may have the option of giving to Seller shall be delivered to Seller by registered mail addressed to Seller at the address hereinafter set forth, or at such other address as Seller may hereafter designate in writing, to-wit: 1111 United States National Bank Building, Portland, Oregon.

Any and all notices which Seller may be required or may have the option of giving to Buyer shall be delivered to it by registered mail addressed to Buyer at 612 South Flower Street, Suite 840, Los Angeles 17, California, or at such other address as Buyer may from time to time designate in writing.

XXII.

This agreement shall be binding upon and insure to the benefit of the respective heirs, executors, administrators, successors and assigns of the parties hereto.

253 In Witness Whereof, Seller has hereunto affixed his hand and seal, and Buyer has caused its corporate name and seal to be hereunto affixed by its duly authorized officers, on the date in this agreement first hereinabove written.

CALIFORNIA INSTITUTE FOR CANCER RESEARCH

Attest:

/s/ H. B. LIBBY,
Assistant Secretary

By /s/ GEORGE CASTERA,
President
Buyer

/s/ CLAY BROWN
Clay Brown (6,000 shares)
acting for himself and all of the other stockholders of Clay Brown & Co. namely:

/s/ DOROTHY E. BROWN
By CLAY BROWN
Dorothy E. Brown (6,000 shares)
By Clay Brown, Attorney-in-fact

/s/ DONALD BROWN
By CLAY BROWN
Donald Brown (6,000 shares)
By Clay Brown, Attorney-in-fact

/s/ PHILIP BROWN
By CLAY BROWN
Philip Brown (6,000 shares)
By Clay Brown, Guardian

/s/ MARILYN BROWN
By CLAY BROWN
Marilyn Brown (6,000 shares)
By Clay Brown, Guardian

/s/ C. H. HILL
By CLAY BROWN
C. A. Hill (500 shares)
By Clay Brown, Attorney-in-fact

/s/ NANCY H. BOOTH
By CLAY BROWN
Nancy H. Booth (500 shares)
By Clay Brown, Attorney-in-fact

[s] C. W. BOOTH
By CLAY BROWN
C. W. Booth (1,000 shares)
By Clay Brown, Attorney-in-fact
Seller

254 POWER OF ATTORNEY

Know All Men by These Presents: That we, Dorothy E. Brown, Nancy H. Booth, and C. W. Booth, owners of capital stock of Clay Brown & Company, an Oregon corporation, have made, constituted, and appointed, and

by these presents do make, constitute, and appoint Clay Brown of the United States National Bank Building, Portland, Oregon, our true and lawful attorney to represent us, and each of us, and in our name, place and stead and for our use and benefit to sell and transfer unto the California Institute for Cancer Research the shares of stock of Clay Brown & Company, indicated opposite the undersigned names, we, and each of us, now own, for the same price and upon the same terms and conditions as Clay Brown sells his stock in Clay Brown & Company. Giving and granting unto our said attorney, full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done to accomplish and complete said sale including but not limited to execution, as our representative and in our behalf, and for each of us, all purchase agreements and any and all documents and instruments and any modifications or amendments of the offer made to the California Institute for Cancer Research, dated January 24, 1953, to sell all of the outstanding stock of Clay Brown & Company, as Clay Brown shall deem proper and advisable.

Witness Our Hands at Portland, Oregon this 28th day of January, 1953.

/s/ Dorothy E. Brown Dorothy E. Brown	6,000 shares
/s/ Nancy H. Booth Nancy H. Booth	500 shares
/s/ C. W. Booth C. W. Booth	1,000 shares

255 POWER OF ATTORNEY

Know All Men by These Presents: That I, Don Brown, am owner of capital stock of Clay Brown & Company, an Oregon corporation, have made, constituted, and appointed, and by these presents do make, constitute, and appoint Clay Brown of the United States National Bank Building, Portland, Oregon, my true and lawful attorney to represent me, and in my name, place and stead and for my use and benefit to sell and transfer unto the California Institute for Cancer Research the Six Thousand (6,000) shares of capital stock of Clay Brown & Company I now

own, for the same price and upon the same terms and conditions as Clay Brown sells his stock in Clay Brown & Company. Giving and granting unto my said representative and attorney full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done to accomplish and complete said sale, including but not limited to execution as my representative and in my behalf of all purchase agreements and any and all documents and instruments and any modification or mandments of the offer made to the California Institute for Cancer Research, dated January 24, 1953, to sell all the outstanding stock of Clay Brown & Company, as Clay Brown shall deem proper and advisable.

Witness my hand at Fortuna, California this 30th day of January, 1953.

/s/ Don Brown

256 POWER OF ATTORNEY

Know All Men by These Presents: That I, C. A. Hill, am owner of capital stock of Clay Brown & Company, an Oregon corporation, have made, constituted, and appointed, and by these presents do make, constitute, and appoint Clay Brown of the United States National Bank Building, Portland, Oregon, my true and lawful attorney to represent me, and in my name, place and stead and for my use and benefit to sell and transfer unto the California Institute for Cancer Research for Five Hundred (500) shares of capital stock of Clay Brown & Company I now own, for the same price and upon the same terms and conditions as Clay Brown sells his stock in Clay Brown & Company. Giving and granting unto my said representative and attorney full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done to accomplish and complete said sale, including but not limited to execution as my representative and in my behalf of all purchase agreements and any and all documents and instruments and any modification or amendments of the offer made to the California Institute for Cancer Research, dated January 24, 1953, to sell all the outstanding stock of Clay

Brown & Company, as Clay Brown shall deem proper and advisable.

Witness my hand at Fortuna, California this 30th day of January, 1953.

/s/ C. A. Hill

257 LETTERS OF GUARDIANSHIP

DEPARTMENT OF PROBATE

No. 69438

State of Oregon,
County of Multnomah, ss:

I, Si Cohn, County Clerk and Ex-Officio Clerk of the Circuit Court of the State of Oregon, in and for the County of Multnomah, do hereby certify that on the 29 day of January, A.D. of 1953 Clay Brown was appointed Guardian of the estates of Philip Frank Brown and Marilyn Claire Brown, minors infants and minors of said County and State, and said Clay Brown having given the bond required by law, is therefore, In the Name of the State of Oregon, duly authorized to take upon himself the guardianship of the estates of said minors and is hereby fully empowered to perform all acts which are or hereafter may be required of him according to law.

In Testimony Whereof, I, Si Cohn, County Clerk and Ex-Officio Clerk of the Circuit Court, have hereunto subscribed my name and affixed the seal of said Court, this 29th day of January, A.D. 1953.

Si Cohn, County Clerk and Ex-Officio Clerk of the Circuit Court,
By Harry N. Nelson, Deputy.

(SEAL)

CERTIFICATE

State of Oregon,
County of Multnomah, ss:

I, Si Cohn, County Clerk, Ex-Officio Recorder of Conveyances and Ex-Officio Clerk of the Circuit Court of the State of Oregon, for the County of Multnomah, which Court has exclusive jurisdiction of all probate proceedings in said County, do hereby certify that the foregoing copy of

Letters of Guardianship has been compared by me with the original, and that it is a correct transcript therefrom, and the whole of such original, as the same appears of record in my office and in my custody.

I further certify that said Letters are now in full force and effect.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court, this 29 day of January, A.D. 1953.

Si Cohn, County Clerk,
By R. E. Sonderen
Deputy

This Court Requires That:

An Inventory and appraisement must be filed within thirty days.

A report showing condition of ward and ward's estate annually.

A final report when ward becomes of age or at expiration of trust.

258 **Exhibit 44-RR**

PROMISSORY NOTE

Dated Feb. 4, 1953

$1,300,000.00

California Institute for Cancer Research, a California nonprofit corporation (hereinafter referred to as the "Institute") for value received hereby promises to pay to Clay Brown, Dorothy E. Brown, Donald Brown, Philip Brown, Marilyn Brown, C. A. Hill, Nancy H. Booth and C. W. Booth the principal sum of One Million Three Hundred Thousand ($1,300,000.00) Dollars, without interest, payable as hereinafter provided:

This note is non-negotiable and evidences the purchase price for the stock of Clay Brown & Company, an Oregon corporation, and notes of Clay Brown and Dorothy E. Brown being purchased by the Institute under a purchase agreement dated February 4, 1953, which purchase agreement is herein incorporated by reference.

The Institute shall pay the $1,300,000.00 evidenced by this note in the manner and at the times provided in said purchase agreement, a summary of which provisions are as follows: $5,000.00 forthwith after the liquidation of Clay Brown & Company, and the balance out of ninety per cent of all royalties or rents received in cash by the Institute under the lease and license agreement dated February 4, 1953 between the Institute and Fortuna Sawmills, Inc. or under any substitute lease agreement with any other lessee covering the assets received by the Institute upon the liquidation of Clay Brown & Company. Such payment shall be made by the Institute within five days after receipt by the Institute of each payment of such royalties or rental. The Institute may prepay any or all of the amount remaining unpaid hereon at any time. The entire balance of this promissory note shall in any event become due and payable on the 31st day of January, 1963. The promisee shall have the right, at his option to accelerate the entire unpaid balance in the event that the Institute breaches any provisions of said
259 purchase agreement or in the event that the Institute shall fail to pay to the promisee hereon a total of $250,000.00 during any two consecutive lease years during the life of the lease referred to in said purchase agreement. The foregoing does not purport to be a complete summary of the provisions of said purchase agreement relating to payments, and payments shall be made under this note in accordance with all applicable provisions of said purchase agreement, whether or not summarized above and not otherwise. Payments made by the Institute to the promisee shall be allocated as provided in said purchase agreement.

After this note becomes due, either on the maturity date of January 31, 1963 or upon acceleration as above provided, any unpaid balance then remaining shall bear interest at the rate of five per cent per annum.

This note is secured by a deed of trust and a chattel mortgage bearing even date herewith.

In Witness Whereof, the California Institute for Cancer Research has caused this note to be duly executed

and its corporate seal to be hereunto affixed at Los Angeles, California, this 4th day of February, 1953.

CALIFORNIA INSTITUTE FOR CANCER RESEARCH

By George Castera,
President

By H. B. Libby,
Ass't. Secretary

(Corporate Seal)

260 **Exhibit 47-UU**

GENERAL ASSIGNMENT FROM CALIFORNIA INSTITUTE FOR CANCER RESEARCH TO CLAY, BROWN, ET AL.

Whereas, California Institute for Cancer Research (hereinafter called the "assignor"), has purchased, all of the outstanding capital stock of Clay Brown & Company, an Oregon corporation, from the stockholders, Clay Brown, Dorothy E. Brown, Donald Brown, Philip Brown, Marilyn Brown, C. A. Hill, Nancy H. Booth and C. W. Booth (hereinafter called the "assignees"), and two promissory notes in the sum of $125,000.00 from Clay Brown and Dorothy E. Brown; and

Whereas, the assignor has dissolved Clay Brown & Company and as security for payment of the unpaid balance of the purchase price for the stock of Clay Brown & Company and the promissory notes, the assignor simultaneously herewith is giving to the assignees a deed of trust and chattel mortgage covering certain assets of Clay Brown & Company received by the assignor upon the dissolution of said corporation; and

Whereas, the parties desire that the assignor shall make certain assignments to the assignees as additional security for the unpaid balance of the purchase price of the stock of Clay Brown & Company and of the promissory notes.

Now, Therefore, as security for the full and faithful performance by the assignor of all the terms and provisions

of the purchase agreement between the assignor and assignees dated February 4, 1953 and as security for payment by the assignor of the sum evidenced by a promissory note from the assignor to the assignees given pursuant to said purchase agreement, the assignor does hereby assign, transfer and convey to the assignees, their heirs, successors and assigns, all of the assignor's right, title and interest in and to:

261 1. The lease and license agreement dated February 4, 1953 between the assignor as lessor and Fortuna Sawmills, Inc. as lessee.

2. The contracts, agreements, leases and subleases listed in Exhibits "C" and "D" to the above mentioned lease and license agreement dated February 4, 1953.

3. The promissory note executed or to be executed by Fortuna Sawmills, Inc. pursuant to Paragraph V (c) of said purchase agreement dated February 4, 1953.

Provided, However, That this assignment shall in no way affect the right of the assignor to keep and retain for its own benefit and purposes ten per cent of all rental and royalties received by it under the above mentioned lease and license agreement with Fortuna Sawmills, Inc. free from the requirement of payment upon the unpaid balance of the purchase price for the stock of Clay Brown & Company and the promissory notes purchased by the assignor from the assignees as long as the assignor shall have such right under said purchase agreement and is not in default thereunder.

This assignment is given for the sole purpose of assuring and securing to the assignees, their heirs, successors and assigns, the full, complete and faithful performance of said purchase agreement and all other agreements incident thereto and said assignees, and each of them, and their respective heirs, successors and assigns in their own names or in the name of the assignor as they shall elect, shall have the right to enforce the agreements and contracts herein assigned, and each of them, and any or all provisions thereof, by legal proceedings or otherwise.

Provided in all events, however, that when said purchase agreement has been fully performed and the pur-
262 chase price for the stock of Clay Brown & Company and the promissory notes has been fully paid by the assignor, this agreement shall be of no further force or effect.

In Witness Whereof, California Institute for Cancer Research, pursuant to a resolution of its Board of Directors duly and legally adopted, has caused these presents to be signed by its authorized officers and its seal to be hereunto affixed this 4th day of February, 1953.

CALIFORNIA INSTITUTE FOR CANCER RESEARCH

By /s/ GEORGE CASTERA,
President

By /s/ H. B. LIBBY,
Asst. Secretary

263 **Exhibit 49-WW**

LEASE AND LICENSE AGREEMENT

This Lease and License Agreement, made and entered into this 4th day of February, 1953, by and between California Institute For Cancer Research, an no-profit corporation organized and existing under and by virtue of the laws of the State of California, hereinafter referred to as Lessor, and Fortuna Sawmills, Inc., a California corporation, hereinafter referred to as Lessee;

WITNESSETH:

That, for and inconsideration of the mutual covenants and agreements herein contained, and other good and valuable consideration, Lessor hereby leases and licenses to Lessee, and Lessee hereby leases and licenses from from Lessor:

(a) The real property, together with improvements thereon as listed and set forth on Exhibit "A" attached hereto and by this reference made a part hereof;

(b) The personal property listed and set forth on Exhibit "B" attached hereto and by this reference made a part hereof;

(c) The good will of Clay Brown & Company;

(d) The patents, patent applications, trademarks and inventions, timber and logging contracts, listed and set forth on Exhibit "C" attached hereto and by this reference made a part hereof;

(e) Subleases as listed and set forth on Exhibit "D" attached hereto and by this reference made a part hereof. All of the property covered by, and which is the subject of this lease is hereinafter, for convenience, referred to as the "demised premises."

To Have and To Hold for a term of five (5) years, commencing on the 1st day of February, 1953, and continuing for a period of five (5) years thereafter, to and including the 31st day of January, 1958.

It Is Mutually Understood and Agreed that this lease and license agreement is made upon the following covenants, conditions, provisions and agreements:

(1) That, during the term of this lease, Lessee covenants to pay as rental and royalty to Lessor for said
264 demised premises an amount each year equal to eighty (80%) per cent of the net profits resulting from the use and occupancy of the demised premises.

(2) The words "net profits" where used in this lease shall be construed to mean net profits before depreciation, income, franchise, excess profits or other similar federal or state taxes computed in accordance with good accounting practice by public accountants mutually acceptable to the parties hereto, and Lessee may deduct from gross income in the computation of net profits all expenses incident to the operation of said demised premises and of said business, including reasonable salaries to officers, partners, executives and employees, and including also all specific charges which Lessee agrees to assume under this lease (other than rental payable hereunder as provided in paragraph (1) above) and all expenses incident to the determination of the proper rental to be paid in accordance with the terms of this lease and in the construction or interpretation of the terms hereof.

(3) Lessee shall compute the net profits for each semi-annual period during the term of this lease, beginning

with the three month period ending on the last day of April, 1953, and each six (6) month period thereafter. On or before the thirtieth (30) day following the close of each semi-annual period, Lessee shall pay to Lessor the rental and royalties so computed for the preceding semi-annual accounting period (or shorter first and last period of three months) in accordance with the provisions hereof.

(4) If the operations of Lessee shall have resulted in a loss during any prior semi-annual period or periods then such net profits for any subsequent semi-annual period may first be applied by the Lessee toward the recovery of any such loss before any further semi-annual rental payments shall become due the Lessor hereunder.

(5) Lessor shall have the right at its option to cancel and terminate this lease on a thirty day written notice, in event that the Lessee shall not have paid to Lessor a total sum of $277,778.00 as rental and royalties during any two consecutive full annual accounting periods. For the sole purpose of calculating the amounts paid by the Lessee to the Lessor in rentals and royalties during any two consecutive calendar years, there shall be added to the cash amounts so paid, the aggregate amounts expended or incurred for capital improvements or additions in said two consecutive calendar years.

265 Lessee shall use and exert its best efforts at all times to cause said demised premises to be productive of the highest possible net profits consistent with good business judgment and sound and economical operations but the rentals hereunder shall accrue only in event that net profits are earned through the operation of the demised premises and the business to be conducted by Lessee upon or in connection therewith. Lessee shall operate and conduct the business herein contemplated continuously (on normal work days and during normal working hours) during the term of this lease, but failure so to conduct said business by reason of strikes, acts of providence, or other causes beyond the control of Lessee shall not be deemed a default by Lessee in the requirements hereof. Lessee alone shall bear any and all losses suffered or incurred by it in the operation of the business herein contemplated.

(7) Lessor shall not be called upon at any time or in any manner to pay or cause to be expended any sums for the maintenance or repairs of said demised premises or personal property, provided that nothing herein contained shall be construed as preventing Lessee from deducting such costs consistently with the provisions of the next following paragraph in computing rental due hereunder.

(8) Lessee shall maintain said demised premises in a good state of repair, ordinary wear and tear, fire and other unavoidable casualty alone being excepted. Lessee may, at its discretion, alter, add to, or improve, or repair the demised premises with the mutual understanding that the costs and expenses of such alterations, additions, improvements, or repairs, if subject to capitalization as required by the Federal Income Tax Regulations, shall be capitalized and the amount thereof credited upon the next installment or installments of rental due to Lessor; provided, however, that Lessee shall not expend or incur expenses for any such capital improvements or additions during any full annual accounting period described in paragraph (3) hereof in excess of the sum of Twenty-five Thousand ($25,000.00) Dollars without the written consent of Lessor. In event that any such alterations, additions or improvements or repairs shall not be subject to capitalization as required by the Federal Income Tax Regulations, then the costs thereof shall be charged as an expense in the operation of Lessee's business. Any and all such alterations, additions, and improvements or repairs made in and to the demised premises shall be and remain the property of Lessor, and Lessee shall
266 execute and deliver to the Lessor all such documents as may be necessary to convey title to the same to Lessor. Automotive equipment and other expendable personal property shall be replaced by Lessee at Lessee's cost and expense, and the title thereto shall vest in Lessor.

(9) Lessee shall pay in cash the rental under the subleases listed in Exhibit "D" attached hereto. Said rental shall be charged by the Lessee as a normal business expense prior to the determination of net profits upon which the rental and royalties to the Lessor are to be calculated.

(10) Lessee shall pay before delinquent all general property taxes levied or assessed against said demised premises; and shall keep all of said demised premises at all times from and after the time of the commencement of the terms of this lease, free and clear of all mechanics' liens or other liens of like nature not existing upon the commencement of said term. Lessee shall post and keep posted in prominent places on the demised premises notices of non-responsibility of Lessor for work, labor and materials furnished to Lessee.

(11) Lessor or its agents, at all times during reasonable business hours, shall have the right of access to the demised premises for the purposes of inspection of the premises and books thereof.

(12) Lessee shall, at its expense, insure the demised premises, and as well, the operations conducted thereon or in connection therewith, against such risks as may be mutually agreed upon by the parties hereto. Lessee agrees to furnish to Lessor a list and description of all types of insurance in force on the first day of July of each and every calendar year during the term of this lease or any extension thereof, and the failure on the part of Lessor to notify Lessee of its dissatisfaction with the adequacy of such insurance coverage shall demonstrate the concurrence of Lessor in the adequacy thereof.

(13) In event of damage to or destruction of said demised premises by fire or other insured cause, the proceeds of insurance policies covering such rish shall be used to restore and rebuild said premises to the mutual satisfaction of the parties hereto, subject, however, to the terms and conditions of any mortgage upon said premises.

(14) This lease shall not be assigned by Lessee either directly or indirectly, nor by operation of law without the express written approval of Lessor, and the consent by Lessor to one or more such assignments shall not be deemed or considered a waiver of the requirement
267 that Lessor consent in writing to any further or subsequent assignments nor be deemed the consent of Lessor to any such further or subsequent assignments: Neither said demised premises nor any of the

personal property which is the subject of this lease shall be sublet by Lessee without first obtaining the written consent of Lessor. During the continuance of this lease a majority of all of the issued and outstanding capital stock, together with the full and complete voting right appurtenant thereto of Lessee, must be held only by such persons as are approved in writing by Lessor, and unless Lessor shall have approved in writing the persons holding a majority of the issued and outstanding stock of Lessee, together with the full and complete voting rights appurtenant thereto, then and in such event, Lessor may, at its election, cancel and terminate this lease by giving to Lessee a written notice of such default and upon the failure of Lessee completely to cure said default within a period of thirty (30) days from the time of giving of said written notice this lease shall forthwith terminate.

(15) In event of any default of Lessee under the provisions of this lease, other than a default in the payment of rental, or default in payment of obligations and liabilities assumed concurrently herewith by Lessee in connection with the purchase of current assets by Lessee from Lessor, or in event of any violation by Lessee of any of the terms or conditions of this lease, Lessor shall serve notice, on Lessee of such default or violation. If, within thirty (30) days after receipt of such notice, Lessee fails to commence and thereafter diligently to proceed to cure such default or violation, then, in addition to such other remedies as may be provided by law, Lessor shall have the option and right to declare this lease cancelled and terminated and to reenter said demised premises or any part thereof, and to take possession of all or any part of said demised premises either with or without process of law; and thereafter, all of the rights of Lessee hereunder shall terminate and Lessee shall execute any and all documents or instruments necessary to reconvey to Lessor any and all property or rights acquired by Lessee hereunder. In event that Lessee shall fail to pay any installment or rental or royalty when due and said default shall continue for a period of thirty (30) days after the end of any full annual accounting period, and said default is not cured within said thirty day period without

notice from Lessor, then Lessor shall have the option to forthwith cancel and terminate this lease.

(16) Lessee agrees that in the use of the patents, patent applications, trademarks, and inventions, that it will
268 use its best efforts to improve said patents and inventions, and to develop additional inventions in connection with the operation of said business. Lessee agrees that any such improvements, developments or additional inventions, whether or not used in connection with said business, shall be and at all times remain the property of the Lessor, and Lessee agrees to notify and advise Lessor promptly in writing of any such improvements, developments, or additional inventions so that Lessor may apply for patents and protection thereon, and Lessee agrees to and does hereby indemnify, save and hold harmless Lessor from the claim or claims of any employee, officer, agent, or representative of Lessee who might claim the ownership or any right, title or interest in any such improvement, developments or new inventions.

(17) Lessor is the owner of the name and good will of Clay Brown & Company and Lessee is hereby given the right to use said name or any derivative or variation thereof, including Lessee's name, in the conduct of the business contemplated by this lease during the continuance of this lease or any extension or renewal thereof; provided, however, that upon the final expiration or sooner termination of this lease, then all of said names shall revert to and remain the property of Lessor, and Lessee shall not thereafter be entitled to use said name or names in the conduct of any business competitive with the business to be conducted by Lessee as provided for in this lease, and Lessee shall cause its corporate name to be changed so as to comply with the provisions of this paragraph.

(18) In event that any dispute shall arise between the parties to this lease as to any matter relating hereto or contained herein, or as to the performance of the terms or conditions hereof, such dispute shall be settled by arbitration in the following manner:

Lessor shall appoint an arbiter and shall notify Lessee in writing of the name and address of the person so appointed; Lessee shall, within five days thereafter, ap-

point an arbiter and shall notify Lessor in writing of the name and address of the person so appointed. The two arbiters thus appointed shall choose a third, and in the event that they fail to do so within ten days of the date of the appointment of Lessee's arbiter, such third arbiter shall be a person designated by the presiding judge of the Superior Court of Los Angeles County. The three persons so designated shall proceed, in accordance with the rules of the American Arbitration Association, to
269 determine such dispute and shall render their decision therein, and such decision so rendered shall be binding upon both parties to this lease.

(19) Concurrently herewith Lessor has executed, as Buyer, a Purchase Agreement of even date, and this Lease and License Agreement is being assigned by the Lessor under the said Purchase Agreement as security for all of the obligations and liabilities of the Lessor, as Buyer under said Purchase Agreement. In the event of the default by the Lessor as Buyer under said Purchase Agreement, and thereafter the Sellers under said Purchase Agreement become the owners of this Lease and License Agreement, then and in said event the said Sellers shall have the right and privilege at their option to cancel and terminate this lease at any time upon a ten (10) day notice in writing directed to the Lessee.

(20) Until the principal note described in the Purchase Agreement has been paid in full, this Lease and License Agreement may not be amended, changed or modified by the parties hereto without first obtaining the written approval thereof from Clay Brown.

(21) The Leseee agrees to enter into an agreement with Clay Brown wherein and whereby Clay Brown shall be employed as general manager of the Lessee until the expiration or sooner termination of this lease, and if for any reason Clay Brown is unable to unwilling to so act, the person or persons holding a majority interest in the principal note described in the Purchase Agreement shall have the right to approve his successor to act as general manager of Lessee company.

(22) Upon the expiration or sooner termination of this lease, Lessee shall, at the option of Lessor, assign to Lessor

any and all contracts or orders that are assignable and that remain executory at said time.

(23) All notices herein provided shall be addressed and delivered to Lessor at 612 South Flower Street, Suite 840, Los Angeles 17, California, or at such other address as Lessor may from time to time designate in writing.

(24) All notices herein provided for shall be addressed or delivered to Lessee at 1001 Board of Trade Building, Portland, Oregon, or at such other place or places as Lessee may from time to time designate in writing.

IN WITNESS WHEREOF, Lessor and Lessee have caused their corporate names and seals to be affixed by
270 their duly authorized officers, respectively, the date in this Lease and License Agreement first above written.

CALIFORNIA INSTITUTE FOR CANCER RESEARCH

By (signed) GEORGE CASTERA
President
Lessor

ATTEST:

(signed) H. B. LIBBY
Assistant Secretary

SEAL

FORTUNA SAWMILLS, INC.
By (Signed) CALVIN N. SOUTHER
President
Lessee

ATTEST:

(signed) WILLIAM H. KINSEY
Secretary

SEAL

271 State of California
County of Los Angeles, ss:

On this 3rd day of February, 1953, before me appeared George Castera and H. B. Libby, both to me personally known who being duly sworn, did say that he, the said George Castera is the President and he, the said H. B. Libby is the Assistant Secretary of California Institute

for Cancer Research, and that the seal affixed to said instrument is the corporate seal of said corporation, and that the said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said George Castera and H. B. Libby acknowledged said instrument to be the free act and deed of said corporation.

In testimony whereof, I have hereunto set my hand and affixed my official seal, this the day and year first in this, my certificate, written.

MARGUERITE LUMBER
Notary Public for Los Angeles County

My Commission Expires: Feb. 22, 1955

(Seal)

State of Oregon
County of Multnomah, ss:

On this 4th day of February, 1953, before me appeared Calvin N. Souther and William H. Kinsey, both to me personally known who being duly sworn, did say that he, the said Calvin N. Souther is the President and he, the said William H. Kinsey is the Secretary of Fortuna Sawmills, Inc., and that the seal affixed to said instrument is the corporate seal of said corporation, and that the said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said Calvin N. Souther and William H. Kinsey acknowledged said instrument to be the free act and deed of said corporation.

In testimony whereof, I have hereunto set my hand and affixed my official seal, this the day and year first in this, my certificate, written.

JOHN R. SABIN
Notary Public for Oregon

My Commission Expires: Oct. 26, 1956

(Seal)

272 EXHIBIT "A"

LAND:

That real property located in the County of Humboldt, State of California bounded and described as follows:

Beginning at the southwest corner of the southeast quarter of the southwest quarter of Section 2, in Township 2 North Range 1 West, Humboldt Meridian;

and running thence east on the section line 23 chains, more or less, to the west line of the strip of land used and occupied by the Northwestern Pacific Railroad Company;

thence northwesterly along the west line of said strip of land 20.75 chains, more or less to the north line of the southeast quarter of southwest quarter of said section;

thence west along the subdivision line to the northwest corner of said subdivision;

and thence south on the west line of the same 20 chains to the point of beginning and containing approximately 39.23 acres.

That parcel in the northeast quarter of the southwest quarter of Section 2 of Township 2 North, Range 1 West, Humboldt Meridian, described as follows:

Beginning at a point on the south line of said subdivision located south 89 degrees 32 minutes west 196.09 feet from the southeast corner of said subdivision, said point of beginning being in the center line of the Northwestern Pacific Railroad right-of-way; running thence from said point of beginning along said south line of said sub-division, south 89 degrees 32 minutes west 106.29 feet to an iron pipe monument designated "B" on survey by Richard B. Stipovich for Clay Brown & Co., Inc., completed September 27, 1949; thence continuing along said south line 89 degrees 32 minutes west 613.98 feet; thence north 28 minutes west 210 feet; thence north 89 degrees 32 minutes east 655.67 feet to the center line of said right-of-way; thence along said center line south 17 degrees 34 minutes east 219.71 feet to the point of beginning, and containing 3.15 acres, not including the area of the aforementioned right-of-way.

BUILDINGS

Sawmill "A"
Mill "A" Sorting Shed
Sawmill "B"
Mill "B" Sorting Shed.
Planing Mill
Office
Miscellaneous Buildings:
Shop
Carrier Garage
Saw Shed
273 Drag Saw Shed
Toilet #1
Toilet #2
Oil House
Power Service Shed
Tool Shed
Store House
Log Scaler Shed
Log Unloader Shed
Pump House #1
Pump House #2
Pump House #3
Fire Pump House
Hose House #1
Hose House #2
Hose House #3
Hose House #4
Hose House #5

274 EXHIBIT "B"

MACHINERY AND EQUIPMENT:

All machinery and equipment in Sawmill "A" constituting a Swedish gan mill complete including:

Log haul per Mill Engineering & Supply catalog No. 502
Log kicker
Log guide per catalog No. 181
Infeed carriage per catalog No. 171
36" super gang saw per Mill Engineering & Supply Company catalog No. 143

Roller case behind gang saw per catalog No. 190
Transfer chain to edger
Transfer skids
Shadow line guide.

All of above manufactured by Mill Engineering & Supply Company of Seattle, Washington.

1½ ton chain hoist
Portland Iron Works 6" by 48" Style E LH and stub edger
24" thirteen-saw gang trimmer manufactured by Peters Co., Portland, Oregon
5¾ x 4¾ x 5 Gardner-Denver Model WBQ vertical two-stage water-cooled six cylinder air compressor complete including motor and 30" x 7' air receiver
Yates-American LH vertical 60" resaw
Rolls
Transfers
Conveyors
4 power panels, and

All necessary related items such as:

Motors
Switches
Pipe and fittings
Fire apparatus
Saws and tools, and in addition

Filing room equipment including:

Armstrong No. 7-I filing machine
No. 22 Armstrong automatic gan saw sharpener
No. 7 Armstrong gan saw filing clamp
No. 4 Armstrong saw stretcher roll
Cast iron leveling block
No. 6 Armstrong swage
No. 3 Armstrong shaper and
All related motors, switches, chains and conveyors.

• • • • •

All machinery and equipment in Mill "A" Sorting Shed including:

Rolls and transfers
Motors
Chain
Pipe and fittings
Fire apparatus
Tools, and
Miscellaneous equipment

276 All machinery and equipment in Sawmill "B" constituting a complete band mill including:

Log haul
Log dock
Transfers
Log stop and loader
3 arm Simondson pattern log turner
Canting gear
9' Star-Cunningham RB ban mill No. 3
Carriage
Carriage drive

All of above except Star-Cunningham band mill and log haul manufactured by Peters Co., Portland, Oregon.

8" x 54" six-saw edger manufactured by Portland Iron Works, Portland, Oregon

Eleven-saw trimmer manufactured by Peters Co., Portland, Oregon

Gardner-Denver 7½ x 5¾ x 5 compressor Model No. WBH-4012 with 24" x 6" air receiver complete

Two power panels
Saw sharpener
Roller and stitcher
Saw hoist
Welder
Rollers and transfers
Conveyors
Pipe and fittings
Fire apparatus
Tools and miscellaneous equipment and all related motors

• • • • •

All machinery and equipment in Mill "B" Sorting Shed including:

Chain
Transfers
Motors
Pipe and fittings
Fire apparatus

277 All machinery and equipment in Planing Mill constituting a complete planing mill and sorting shed including:

Yates-American A-66 6" x 15" planer/matcher, manufacturer's Serial No. B-657
Spray treating equipment
Electric Swede pull-off manufactured by Keystone Machine Works, Roseburg, Oregon
No. 36 Irvington cut-off saw manufactured by Irvington Machine Works, Portland, Oregon
Power panel

Head and knife grinders including Hanchett 32" grinder
Chain and related motors and including:

Rolls and transfers
Pipe and fittings
Saws
Heads and knives
Tools and miscellaneous equipment

70" steel plate single ballbearing exhaustor manufactured by Central Blowpipe Manufacturing Company, Escalon, California and related motors and equipment.

* * * * *

All machinery and equipment in Shop including:

Excelsior 21" drill press manufactured by Rogersford Foundry & Machine Company, Rogersford, Pennsylvania
300 amp. General Electric portable horizontal arc welder
8" stroke No. 6156 Miller Knuth motorized power hack saw
Stanley 6" double end cylinder
18" swing 7' bed Bradford lathe manufactured by Bradford Machine & Tool Company, Cincinnati, Ohio

Model 110 Malsbury Steam Cleaner, and
Related motors
Pipe and fittings
Tools and miscellaneous equipment.

All machinery and equipment in Carrier Garage including:

Ross Series 90 Straddle lumber carrier Type 90-7956 manufacturer's Serial No. 2023 Engine No. 195138

Tools and miscellaneous equipment, but
Excluding:

1 Hyster Lift Truck RT-150 Serial No. 50676 Motor No. 248798
1 Hyster Straddle Truck Model M3-5766 Serial No. 63528 Motor No. 295871
278 1 Osgood Mobile Crane Model 715, Serial No. 5383 Caterpillar Motor D13000 Serial No. 1F8528
1 Hyster Space Saver Lift Truck Model RT-150 Serial No. 56146 Motor No. 295573
1 Hyster Straddle Truck M3-5766 Serial No. 55694 Motor No. 24020

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No. 60 shaving and edging Burner manufactured by Central California Blowpipe Company, Inc., Escalon, California, complete with:

Spark screen
Pipe ladder and
Steel cat-walk

• • • • •

50′ air-cooled shaving and edging Burner manufactured by Eureka Boiler Works, Eureka, California, complete with:

Screen
Ladder, and
Cat-walk

• • • • •

One DeWalt Cut-Off Saw and Guard housed in Saw Shed

• • • • •

All machinery and equipment in and related to Drag Saw Shed including:

Model DKS Serial No. 116-T 9' Blue Babe chain saw
Miscellaneous wiring, switches, motor, tools and equipment.

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All tools and miscellaneous equipment in toilets, oil house, tool shed, store house, log scale shed, log unloader shed, pump houses, fire pump houses and hose houses, including:

Fire pumps
Sump pumps
Power panels
Fire apparatus
Log unloading winch and motor
Rigging, and other related items, tools, and equipment.

279 All wiring, switches, motors, circuit breakers and related equipment in Power Service Shed.

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All equipment and machinery in Yard:

Power service
Conveyors
Motors
Dust cooling system
Blowers
Pipe and fittings
Tanks
Boom and clam shell for use with Model 715 Osgood Mobile Crane but excluding said crane
Model D-4 Caterpillar Tractor Serial No. 7-U-771 equipped with Traxcavator No. 3569 blade, and
Hyster D-4 winch No. BW-6777
11 x 13 Wilamette Humboldt three-drun yarder complete with controls, motor, rigging and related equipment
A portable Chrysler engined Byron Jackson pump Engine No. C-36-6120
Model No. 36 Fakhiem electrically operated price and gallonage-indicating gasoline pump
3 fully equipped water wells with pumps

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All furniture, fixtures and equipment in Office Building including:

2—60" x 32" oak typewriter desks
3—60" x 34" oak double pedestal desks
1—60" x 36" and
1—69" x 38" walnut-mahogany executive desks
1—60" x 34" double pedestal oak desk with linoleum top
1—72" x 34" oak table
6—oak side chairs
4—oak swivel arm chairs
2—Shepard steel upholstered posture chairs
3—Shaw-Walker four drawer steel letter files
1—Red leather upholstered davenport
1—Matching chair
3—Walnut-mahogany side chairs
1—Sturgis autographic register
1—ten-inch Royal typewriter Serial No. KMM-3685320
280 1—fourteen-inch Royal typewriter Serial No. KMM 14-R2632280
1—Friden eight-column electric calculator Serial No. S8-101189
1—ten-key Remington Rand electric adding machine Serial No. 93-797385
1—ten-key Victor electric adding machine Serial No. 5716660
1—nine-column Burroughs hand calculator Serial No. 5-974363
1—Model 74 seven-column Todd Check Protector Serial No. N747-R4418
1—Detex watchman's clock with ten stations
1—Johnson floor polisher

Miscellaneous items including:

Chair pads
Waste baskets
Desk trays
Miscellaneous desk accessories
Rubber mats
Clocks
Cleaning equipment, etc.

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TRUCKS AND AUTOMOBILES

1—1948 White dump truck—Serial No. 244012 Engine No. 120A16153
1—1949 Chevrolet pick-up—Engine No. GBA-548945
1—1951 Chevrolet pick-up—Engine No. JBA-1197406
1—1953 Plymouth Cranbrook Savoy—Engine No. P2447791
1—1951 Chevrolet 2-door Sedan—Engine No. JAA-1232922
1—1953 Chrysler 4-door Sedan—Motor No. C-53-8-15860

281 EXHIBIT "C"

Timber purchase and sales agreement dated October 31, 1950 between Clay Brown & Company and Henry J. and Edith F. Vicenus.

Log sale and purchase agreement entered into September 15, 1952 between William E. Layman and Clay Brown & Company including a supplement dated September 30, 1952 correcting expiration date of the contract to read January 1, 1954.

Agreement dated August 1, 1952 between Robert K. Olson and Clay Brown & Company covering sale by Olson and purchase by Clay Brown & Company of logs, said agreement to expire May 1, 1953.

Agreement dated January 31, 1950 between Northwestern Pacific Railroad Company and Clay Brown & Company concerning operation and maintenance of spur railroad track on Clay Brown & Company properties near Rohnerville, Humboldt County, Califiornia.

Contract of October 27, 1949 between Clay Brown & Company and Pacific Gas & Electric Company covering installation and maintenance of electric service.

Contract dated January 15, 1951 between Clay Brown & Company and Pacific Gas & Electric Company covering installation and maintenance of electrical service.

Contract dated November 30, 1949 and expiring February 28, 1954 between Standard Oil Company of California and Clay Brown & Company relating to sale by Standard Oil Company to Clay Brown & Company of Chevron gasoline.

282 EXHIBIT "D"

LEASE:

Field warehouse lease of August 25, 1952 between Lawrence Warehouse Company and Clay Brown & Company comprising certain real property and pond area on Clay Brown & Company millsite, Fortuna, California.

Field warehouse lease dated September 22, 1952 between Lawrence Warehouse Company and Clay Brown & Company covering areas designated as Units B and C for the purpose of warehousing logs on Clay Brown & Company millsite, Fortuna, California.

Lease agreement dated October 31, 1952 and expiring October 31, 1953; entered into between Brown Timber & Investment Company and Clay Brown & Company covering rental and use of Hyster Model M-3-5766 Straddle Truck.

Lease agreement dated June 16, 1952 and expiring June 16, 1953; entered into between Brown Timber & Investment Company and Clay Brown & Company covering rental and use of Hyster Model RT 150 Lift Truck.

Lease agreement dated June 15, 1952 and expiring June 15, 1953; entered into between Brown Timber & Investment Company and Clay Brown & Company covering rental and use of Hyster Model M-3-5766 Straddle Truck.

Lease agreement dated March 30, 1952 and expiring March 31, 1953; entered into between Brown Timber & Investment Company and Clay Brown & Company covering rental and use of Model 715 Osgood Mobile Crane.

Lease dated December 7, 1951 and expiring December 31, 1954 between The United States National Bank of Portland, Oregon and Clay Brown & Company covering office premises in Rooms 1109, 1110 and 1111 U. S. National Bank Building.

Exhibit 50-XX

283

GENERAL ASSIGNMENT TO FORTUNA SAWMILLS, INC.

KNOW ALL MEN BY THESE PRESENTS, That CALIFORNIA INSTITUTE FOR CANCER RESEARCH, a California non-profit corporation (hereinafter called the "Assignor"), for and in consideration of the sum of Ten ($10.00) Dollars and other valuable consideration in hand paid by FORTUNA SAWMILLS, INC., a California corporation (hereinafter called the "Assignee"), the receipt of which is hereby acknowledged, does hereby sell, assign and transfer to the Assignee, its successors and assigns, all of the Assignor's right, title and interest in and to all cash (in excess of Five Thousand ($5,000.00) Dollars which sum is hereby retained), bank accounts, inventory (including lumber inventory, log inventory and any other inventory) accounts receivable, notes, trade acceptance, chose in action, and any and all other assets, tangible or intangible which the Assignor received or is entitled to receive as sole stockholder upon the liquidation of Clay Brown & Company, an Oregon corporation, *save and except*, only such assets (other that the beforementioned $5,000.00) received by the Assignor upon the liquidation of Clay Brown & Company which are leased and licensed to Fortuna Sawmills, Inc. under the lease and license agreement dated February 4, 1953, by and between the Assignor as lessor and the Assignee as lessee executed by the parties contemporaneously herewith, *provided*, however, that the assignment of the assets herein is subject to all of the liabilities and obligations of Clay Brown & Company assumed by the Assignor or which accrued to the Assignor upon or by virtue of the liquidation of Clay Brown & Company and the receipt by the Assignor of all the assets of Clay Brown & Com-

284 pany upon such liquidation, except two promissory notes owed by Clay Brown & Company to Clay and Dorothy E. Brown in the aggregate principal amount of $125,000.00, all of which liabilities, except for said notes, the Assignee assumes and agrees to pay; and

The Assignor hereby authorizes the Assignee in the Assignor's name to sue, give releases, take any legal steps and do all things the Assignee may deem necessary or ap-

propriate in carrying out the intention of this general assignment which is to grant to the Assignee, subject to the liabilities as aforesaid, all of the assets (except for the beforementioned $5,000.00), tangible and intangible, of Clay Brown & Company received by the Assignor upon the liquidation of Clay Brown & Company, other than the assets leased by the Assignor to the Assignee under the beforementioned lease.

IN WITNESS WHEREOF, CALIFORNIA INSTITUTE FOR CANCER RESEARCH pursuant to a resolution of its Board of Directors duly and legally adopted has caused these presents to be signed by its authorized officers and its seal to be hereunto affixed this 4th day of February, 1953.

CALIFORNIA INSTITUTE FOR CANCER RESEARCH

By GEORGE CASTERA
President

By H. B. LIBBY
Ass't. Secretary

(Corporate Seal)

285 STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

On this 28 day of February, 1953, before me, a notary public in and for said County and State, resident therein, duly commissioned and sworn, personally appeared George Castera known to me to be the president of the corporation that executed the within instrument, and personally appeared H. B. Libby known to me to be the Ass't. Secretary of the corporation that executed the within instrument, and both of such persons acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

ALTA B. HERRICK
Notary Public in and for said County and State

My Commission Expires 12/6/54

(SEAL)

Exhibit 51-YY

Dated Feb. 4, 1953

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ASSUMPTION AGREEMENT OF FORTUNA SAWMILLS, INC.

WHEREAS, FORTUNA SAWMILLS, INC., a California corporation, hereinafter called "Fortuna", received by general assignment from CALIFORNIA INSTITUTE FOR CANCER RESEARCH, hereinafter called "California Institute", all the assets, tangible and intangible received by California Institute upon the liquidation of Clay Brown & Company, other than certain assets leased by Fortuna from California Institute under a lease and license agreement; and

WHEREAS, California Institute executed said general assignment to Fortuna pursuant to paragraph V (c) of the purchase agreement dated February 4, 1953 between Clay Brown and certain other stockholders of Clay Brown & Company, an Oregon corporation, and California Institute, which paragraph provides that Fortuna shall agree in writing to assume to pay out of the assets so assigned, all of the liabilities of Clay Brown & Company except certain notes to stockholders, and to pay California Institute as therein provided a sum equal to the excess of such assets over the assumed liabilities.

NOW, THEREFORE, FORTUNA hereby assumes and agrees to pay when due, out of and only out of the assets received by Fortuna under the general assignment from California Institute, all of the current and deferred expenses, obligations and liabilities of Clay Brown & Company as shown on the audit of the books of Clay Brown & Company to be prepared by its accountants, Peat, Marwick, Mitchell & Co. of Portland, Oregon, as of the close of business on January 31, 1953, excepting the notes owed by Clay Brown & Company to Clay Brown and Dorothy E. Brown in the aggregate sum of $125,000.00.

287 Fortuna further agrees to pay to California Institute out of the assets so received under said general assignment a sum equal to the amount by which the total assets so received as shown on the beforementioned audit

as of January 31, 1953 exceeds the total liabilities and obligations assumed hereunder as shown on said audit, which excess shall be evidenced by and paid in accordance with a promissory note due and payable on or before five years from the date hereof, without interest, but with an acceleration clause in the event Fortuna defaults in the payment of any of said liabilities herein assumed by Fortuna. In determining the beforementioned excess of assets over liabilities, such assets and liabilities shall be computed at the book value thereof as disclosed by said audit as of January 31, 1953.

It is understood that if it shall become necessary for Fortuna to obtain independent financing and credit, and in order to do so it shall be required to obtain the subordination of said note to said financing or credit then California Institute agrees to so subordinate said note.

IN WITNESS WHEREOF, FORTUNA SAWMILLS, INC. has caused this assumption agreement to be duly executed in its name and on its behalf by its officers duly authorized thereunto by the Board of Directors.

FORTUNA SAWMILLS, INC.

By CALVIN N. SOUTHER
By WILLIAM H. KINSEY

(SEAL)

288 STATE OF OREGON }
COUNTY OF MULTNOMAH } ss.

On this 4th day of February, 1953, before me, a notary public in and for said County and State, resident therein, duly commissioned and sworn, personally appeared Calvin N. Souther known to me to be the president of the corporation that executed the within assumption agreement, and personally appeared William H. Kinsey, known to me to be the secretary of the corporation that executed the within assumption agreement, and both of such persons acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

JOHN R. SABIN
Notary Public in and for said County and State

(SEAL) My Commission Expires Oct. 26, 1956

Exhibit 52-ZZ

289 PROMISSORY NOTE

$20,991.79 May 15, 1953

FORTUNA SAWMILLS, INC., a California corporation (hereinafter referred to as "Fortuna"), for value received hereby promises to pay to CALIFORNIA INSTITUTE FOR CANCER RESEARCH (hereinafter referred to as the "Institute"), on or before February 4, 1958 the principal sum of Twenty Thousand, Nine Hundred Ninety-one and 79/100 (20,991.79) Dollars without interest.

This note is given pursuant to an Assumption Agreement of Fortuna Sawmills, Inc. executed on February 4, 1953 as required by paragraph V(c) of a Purchase Agreement dated February 4, 1953 between Clay Brown and certain other stockholders of Clay Brown & Company.

In the event Fortuna defaults in the payment of any of the liabilities assumed by Fortuna under the beforementioned Assumption Agreement, the full amount due under this note shall become immediately due and payable upon such default at the option of the Institute.

The beforementioned paragraph V(c) of the Purchase Agreement provides that in the event it shall become necessary for Fortuna to obtain independent financing or credit, and in order to do so, it shall be required to obtain the subordination of this note to said financing or credit, then the Institute agrees to so subordinate this note. In accordance with such provision this note is hereby subordinated to any and all sums owed by Fortuna to The United States National Bank of Portland, Oregon, whether or not secured by a mortgage or warehouse receipts. This note may from time to time be subordinate to other indebted-

nesses of Fortuna in accordance with the beforementioned provision of paragraph V(c) of the Purchase Agreement.

IN WITNESS WHEREOF, FORTUNA SAWMILLS, INC. has caused this note to be duly executed in its name and on its behalf by its duly authorized officers.

FORTUNA SAWMILLS, INC.

By CALVIN N. SOUTHER
Calvin N. Souther,
President

By WILLIAM H. KINSEY,
William H. Kinsey,
Secretary

(Corporate Seal)

Exhibit 53-AAA

290 EMPLOYMENT AGREEMENT

AGREEMENT made and entered into as of the 4th day of February, 1953 by and between FORTUNA SAWMILLS, INC., a California corporation (hereinafter referred to as the "company") and CLAY BROWN.

1. The company hereby employes Brown as general manager of the company for the term of five years from February 1, 1953 to and including January 31, 1958. It is intended that the employment of Brown shall continue during the period of the lease dated February 4, 1953 between the company as lessee and California Institute for Cancer Research as lessor, and if said lease shall for any reason terminate or be terminated prior to the expiration date specified in said lease, then the employment of Brown hereunder shall likewise terminate upon the termination of said lease.

2. Subject to the supervisory control of the board of directors of the company, Brown's duties as general manager shall include supervision and management of the following: operation of the company's facilities at Fortuna, California; the manufacture and sale of the company's products; performance by the company of the lease and license agreement dated February 4, 1953 between the company as

lessee and California Institute for Cancer Research, as lessor; employment and fixing of the compensation of employees; and any and all other duties usually incident to those of a general manager of a business of the type of that carried on by the company, including such other duties as the board of directors may from time to time prescribe. During the term of this agreement Brown shall devote his best efforts and such portion of his time as shall be necessary to carry out his duties hereunder, and Brown shall not, directly or indirectly, engage in any activity or business which competes with the business carried on by the company.

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3. The Company shall pay to Brown a salary of Twenty-five Thousand ($25,000.00) Dollars per year as his entire compensation for services to the company during the term of this agreement. Such salary shall be paid in equal monthly installments.

4. This agreement shall inure to the benefit of, and shall be binding upon the company, its successors and assigns.

IN WITNESS WHEREOF the parties have executed this agreement as of the date first above mentioned.

FORTUNA SAWMILLS, INC.
By CALVIN N. SOUTHER

CLAY BROWN
Clay Brown

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SPECIAL MEETING OF BOARD OF DIRECTORS of FORTUNA SAWMILLS, INC.

A special meeting of the board of directors of Fortuna Sawmills, Inc. was held at 2 o'clock p.m. on October 26, 1954, at the 10th Floor of the Board of Trade Building, Portland, Oregon.

Present were Calvin N. Souther, William H. Kinsey and Raymond P. Underwood constituting all of the directors of the corporation. Mr. Souther acted as chairman of the meeting and Mr. Kinsey acted as secretary.

The chairman presented to the meeting the letter received from Clay Brown announcing his resignation as general manager of the corporation. Upon motion duly made and seconded the following resolutions were unanimously adopted:

RESOLVED, that the resignation of Clay Brown as general manager of the corporation be and hereby is accepted and the employment agreement dated February 4, 1953 between this corporation and Clay Brown be and the same hereby is terminated effective October 31, 1954; and

RESOLVED FURTHER, that Clay Brown shall be retained by the corporation in an advisory capacity and the corporation shall pay him a salary of $1,000.00 per month for such services; and

RESOLVED FURTHER that no successor to Mr. Brown as general manager will be appointed at this time, it having been determined by the board of directors that the present personnel of the corporation, particularly Mr. C. W. Booth in the Portland office and Mr. C. A. Hill at the sawmill, are capable of carrying on the business of the corporation with the advisory services to be extended by Mr. Brown.

There being no further business the meeting was adjourned.

WILLIAM H. KINSEY
William H. Kinsey,
Secretary

293 SPECIAL MEETING OF THE
BOARD OF DIRECTORS
of
FORTUNA SAWMILLS, INC.

A special meeting of the board of directors of Fortuna Sawmills, Inc., was held at 10 A.M. on November 8, 1954, at 1001 Board of Trade Building, Portland, Oregon.

Present were Calvin N. Souther, William H. Kinsey and Raymond P. Underwood, constituting all of the directors of the corporation. Mr. Souther acted as chairman of the meeting and Mr. Kinsey acted as secretary.

On motion duly made and seconded the banking resolution of The United States National Bank of Portland (Ore-

gon) in the form attached to the minutes of this meeting was unanimously adopted.

There being no further business the meeting was adjourned.

WILLIAM H. KINSEY
William H. Kinsey,
Secretary

The undersigned directors hereby approve the foregoing minutes of Fortuna Sawmills, Inc. and hereby waive any and all notice required for the holding of said meeting.

CALVIN N. SOUTHER
Calvin N. Souther

WILLIAM H. KINSEY
William H. Kinsey

RAYMOND P. UNDERWOOD
Raymond P. Underwood

294 BE IT RESOLVED, that The United States National
295 Bank of Portland (Oregon), at any one or more of its offices, be and it hereby is designated as the banking depository of this corporation, and that checks on the company's account shall be signed by any *one* of the following, individually.

Clay Brown, General Manager, or
C. W. Booth, Controller, or
Agnes N. Koch, Bookkeeper

or by any *two* of the following:

Calvin N. Souther, President
William H. Kinsey, Secretary-Treasurer
C. A. Hill, Resident Mill Manager
Don Brown, Assistant Resident Manager
Henry A. Vogel
Claire McCloskey

STATE OF OREGON
COUNTY OF MULTNOMAH } ss.

I, William H. Kinsey, hereby certify that I am the duly elected, qualified and acting secretary of FORTUNA SAWMILLS, INC., a California corporation, and as such in pos-

session of the record book of the corporation containing the records of the meetings of the stockholders and directors thereof; that the within and foregoing is a full, true and complete copy of a resolution duly adopted by the directors of said corporation, at a duly called and held meeting, held on the 8th day of November, 1954, at which a quorum was present and voted in favor of said resolution. I further certify that the officers named in the foregoing resolution have been duly elected and have qualified to the offices designated in said resolution.

IN WITNESS WHEREOF, I have hereunto set my official signature and the seal of said corporation this 8th day of November, 1954.

.....
Secretary.

(Corporate Seal)

Exhibit 55-CCC

296 MINUTES OF SPECIAL MEETING OF THE BOARD OF DIRECTORS OF THE CALIFORNIA INSTITUTE FOR CANCER RESEARCH

A special meeting of the Board of Directors was called to order by the Chairman at 4:30 P.M., Pacific Standard Time at the California Club, 538 South Flower Street, Los Angeles, California, on Tuesday, January 27, 1953, pursuant to written notice thereof duly given January 22, 1953.

Directors present at the meeting when called to order by the Chairman were:

Judge Stanley N. Barnes
Mrs. William Barnhart
Mr. George Castera
Mr. M. Philip Davis
Mr. A. J. Lorenz
Mr. Robert Robinson
Mr. L. H. Seagrave
Dr. Stafford L. Warren
Dr. Vern O. Knudsen
Mr. Kendall Thurston
Dr. Elmer Belt (came in at 5:00 P.M.)

Directors absent from the meeting were:

Mrs. John Buwalda
Mr. K. O. Baker
Mr. John Canaday
Dr. Sidney C. Madden
Mr. Lewis A. Weiss
Judge Frederick F. Houser
Dr. Harry B. Priedgood

Also present was Mrs. Harriet Libby, assistant secretary of the Institute.

The Chairman asked the President, Mr. Castera to preside at the special meeting inasmuch as the matter to be discussed was one in which he had a personal financial interest which had been disclosed to the members of the Industrial Investment Committee.

The President took the chair, announced that a quorum was present and thereafter presided at the meeting.

The President announced that the first thing to be taken up was the proposed deal with Clay Brown & Co. which Mr. Seagrave had submitted to the Industrial Investment Committee, and which the committee had spent considerable time going over. The President then asked Mr. Seagrave if he would review it again inasmuch as some of the directors present had not previously been acquainted with the deal.

297 Mr. Seagrave then reviewed the proposed purchase of Clay Brown & Company of Portland and Eureka, and submitted various papers which are attached to the minutes of this meeting. He disclosed that his interest was a 2% commission, to be paid by the sellers when, as and if payments on the purchase are made.

There ensued a thorough discussion of the contracts to be signed and Mr. Castera stated that the Industrial Investment Committee had voted to accept this proposition.

It was decided that the letter of proposal of Clay Brown & Co. would be eliminated and that the purchase contract and the lease and license agreement would be revised.

Upon motion by Dr. Warren, seconded by Mr. Thurston, and unanimously approved by the directors present (Mr. Seagrave abstaining from voting), the following resolution was adopted:

RESOLVED, That a legal Committee is hereby appointed to consist of Mr. M. Philip Davis, Judge Stanley M. Barnes and Judge Frederick F. Houser to go over the two agreements and make any revisions they felt to be to the best interests of the Institute, and to pass and approve other documents in connection with the proposed purchase.

Upon motion duly made, seconded and unanimously carried (Mr. Seagrave abstaining from voting), the following resolutions were adopted:

RESOLVED, That the president and secretary or assistant secretary of this corporation be and they are hereby authorized and instructed to execute for and on behalf of this corporation the Purchase Agreement by and between Clay Brown, Dorothy E. Brown, Don Brown, Philip Brown, Marilyn Brown, C. A. Hill, Nancy H. Booth, and C. W. Booth, as Sellers; and this corporation, as Buyer, in substantially the same form as outlined in the draft of the Purchase Agreement submitted and approved subject to such changes in terms and/or conditions and/or provisions as the said officers may, in their discretion and with approval of counsel chairman of legal committee, deem to be for the best interests of this corporation; and

BE IT FURTHER RESOLVED, That the president and the secretary or assistant secretary of this corporation be and they are hereby authorized and instructed to execute for and on behalf of this corporation the Lease and License Agreement by and between this corporation as Lessor, and Fortuna Sawmills, Inc. as Lessee, in substantially the same form as outlined in the draft of the Lease and License Agreement submitted and approved subject to such changes in terms and/or conditions and/or provisions as the said officers may, in their discretion and with approval of counsel chairman of legal committee, deem to be for the best interests of this Corporation; and

298 BE IT FURTHER RESOLVED, That the president and the secretary or assistant secretary be and they are further authorized and instructed to execute for and on behalf of this corporation any and all other documents and instruments that may be necessary, required or convenient for the final consummation of all the transactions contem-

plated by said Purchase Agreement and by said Lease and License Agreement.

There being no further business to come before the Board at this time, the meeting was adjourned.

[Illegible]
Secretary

L. H. SEAGRAVE
Chairman of the Board

GEORGE CASTERA
President

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REVISED PROFORMA, SUBSTITUTING APPRAISED VALUATION, BALANCE SHEET

CLAY BROWN & COMPANY

December 31, 1952

ASSETS

Current Assets:		
Cash	$ 17,211	
Accounts and Notes Receivable	127,491	
Inventories—at market	519,807	
Prepaid expenses	11,548	
		$ 676,057
Other Assets:		
Plant, property and equipment at appraised value (Fortuna)	$ 836,759	
Land, 42.38 acres at $1,500	63,570	
Circular saw, omitted from appraisal	1,500	
Supplies	25,000	
Furniture & equipment, Portland & San Francisco	10,376	
Increase in automobiles	2,000	
Timber, less depletion	123,000	
		1,062,205
Deposits and Deferred Charges		2,166
		$ 1,740,428

LIABILITIES

Current Indebtedness:		
Demand notes payable to U. S. Nat'l Bank secured by log inventory	$ 301,392	
Current accounts payable	71,270	
Provision for federal income and Oregon excise taxes	135,000	
Timber contract payable	32,563	
Portion of mortgage debt payable within one yr.	38,916	
		$ 579,141
Long-term debt:		
3-year mortgage note payable, balance to U.S. Nat'l Bk.	$ 104,047	
Less payments due within one year	38,916	
		65,131
Capital Stock and Notes (to be sold):		
Demand Notes to stockholders	$ 125,000	
Common stock, 32,000 shares	32,000	
Capital surplus	13,986	
Earned surplus	466,389	
Surplus from appraisal	458,781	1,096,156
		$ 1,740,428

300 Committee on Industrial Investment
California Institute for Cancer Research
Mr. George Castera, Chairman

Dear Sirs:

Subsequent to the meeting of your committee on Saturday, January 24, 1953, I talked on Sunday at some length with Mr. Clay Brown at Portland, Oregon.

He arranged to send me the Appraisal Survey of the General Appraisal Company, bringing the previous appraisal up to date.

He advised me that the new lessee California corporation to be known as Fortuna Sawmills, Inc., would have initial paid in capital of $25,000, but that it had an authorized capital of $50,000, and that an additional $25,000 would be paid in, if found necessary.

He also stated that he was a signer personally on the mortgage, and that he would also be a personal signer on the new mortgage to the U. S. National Bank, which would be for approximately $101,000, to which it had now been paid down. He hopes to arrange this mortgage on a five year basis, which would make the annual service of it about $23,000, and have the effect of increasing the net current

assets by $80,000. If the bank does not make that arrangement, he feels sure that the bank will make it a three-year loan, on which the annual service would be about $38,000, as it has been.

Mr. Brown advises that he has been assured by the U. S. National Bank that it will continue to lend on logs and lumber, as in the past, with a line up to $400,000.

Mr. Brown read me a memo detailing the working funds they could rely on, which I have reduced to a memorandum, attached hereto. He says that he is in a position to provide funds, or to lend his personal credit to insure adequate funds. He thinks the working capital position will not be as much of a problem as it has been in the past.

There are enclosed the following:

Analysis of the increase in asset value, which shows that the increase has in reality, been only about 20% more in the appraisal than at cost.

A revised, corrected pro-forma balance sheet of Clay Brown & Co.

A pro-forma opening statement of Fortuna Sawmills, Inc. with an estimated revision for April 30th, reflecting the probable position, after reduction of log inventory, payments on taxes, earnings. I believe the opening statement is correct, except for a deduction from cash of $5,000, the down payment to be made prior to the sale of the net asset position.

L. H. SEAGRAVE

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FORTUNA SAWMILLS, INC.

Pro Forma

	At Closing		Estimated At April 30, 1953	
ASSETS				
Cash, taken over	$ 17,211		$ 62,211	
Cash, paid in	25,000			
Accounts & Notes receivable	127,491		127,491	
Inventories—at market	519,807		119,807	
Prepaid expenses	11,548		11,548	
		$701,057		$321,057
Deposits and deferred charges		2,166		2,166
		$703,223		$323,223
LIABILITIES				
Demand notes payable to U.S. Nat'l Bank	$301,392		$ 1,392	
Current accounts payable	71,270		51,270	
Provision for federal income and Oregon excise taxes	135,000		65,000	
Timber contract payable	32,563		32,563	
Portion of mortgage note payable within one year	38,748		38,748	
		$578,973		$188,973
Mortgage note payable, U.S. Nat'l Bk.	$104,047			
Less payments due within one year	38,748			
		65,299		65,299
Note To California Institute (Subordinated to bank loan)		33,951		33,951
Capital stock outstanding & earned surplus		25,000		45,000
		$703,223		$323,223

Net working capital at Jan. 31, 1953:

Current Assets	$701,057
Current Liabilities	578,973
	$122,084

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FORTUNA SAWMILLS, INC.

PROJECTION OF AVAILABLE WORKING FUNDS

	Funds	Assuming that U. S. Nat'l Bk. makes note payable serially in 3 yrs. current funds would be increased as follows:
At Feb. 1, 1953		
Net current assets received	$ 28,000	$ 96,000
New capital	25,000	25,000
Subordination of note to Institute	33,000	33,000
	$ 86,000	$154,000
Reserve for taxes	135,000	135,000
Available funds	$221,000	$289,000
Estimated earings Feb. & Mar.	100,000	100,000
At April 1, 1953	$321,000	$389,000
Taxes due April 15th	64,000	64,000
Balance	$257,000	$325,000
Payment of rent June 1	80,000	80,000
Balance	$177,000	$245,000
Taxes due July 15	54,000	54,000
Balance	$123,000	$191,000
Earnings estimated April, May, June	90,000	90,000
Balance	$213,000	$281,000
Taxes due Oct. 15	18,000	18,000
Balance	$195,000	$263,000
Earnings estimated to Oct. 1	90,000	90,000
Balance	$285,000	$353,000
Payment of rent Dec. 1	144,000	144,000
Balance	$141,000	$209,000
Earnings estimated No., Dec., Jan.	50,000	50,000
Balance at Jan. 31, 1954	$191,000	$259,000

The above projection does not include two sources of working funds, if needed, i.e. $25,000 additional capital and loans of $50,000 from Clay Brown.

CLAY BROWN & CO.

	10/31/52	Appraisal Survey 11/31/52	1/20/53	Increase
Property, Plant & Equipment, at cost:				
Building	$173,520	$173,520		
Equipment and facilities	405,301	406,203		
Automotive, yard and logging equipment	26,992	26,992		
Furniture & Fixtures, Fortuna	7,751	7,751		
Furniture & Fixtures, Portland	7,375	7,375		
Automobiles	13,014	13,014		
	$633,953	$634,855	$ 836,759	$201,904(1)
Land (42.38 acres) (Current market $1,500 per acre)	24,635	24,635	63,570	38,935
Supplies, (Previously expenses. C. W. Booth believes will inventory at at more than $30,000)			25,000	25,000
Circular saw mounting (omitted from inventory at price offered for it)			1,500	1,500
Timber, less depreciation (Scaled at 15,000,000 feet at market of $8.20 per M)	50,927	47,722	123,000	75,278
Additional investment in automobiles			2,000	2,000
Furniture & Fixtures, San Francisco & Portland (previously expenses)			10,376	10,376
	$709,515	$707,212	$1,062,205	$354,993

(1) This increase of 31.8% in appraisal over cost includes many items previously expenses, but picked up and appraised, aggregating $63,063 at cost.

The actual increase in appraisal of property appraised on cost is—

Book value of cost	$634,855
Assets expenses	63,063
Total Cost	$697,918
Appraisal	836,759
Increase	$138,841 or about 20%

This increase is consistent with advance in market for this class of equipment.

MISCELLANEOUS DATA

1. Company began sawmill operation May 1, 1950.

2. Net before taxes:

Year ended April 30, 1951		$415,533
Year ended April 30, 1952		145,078
	(nearly $70,000 expenses)	
Six months to Oct. 31, 1952		207,567
		$768,000
Average annual earnings before taxes		$307,270
Capital items expensed during 2½ years:		
Supplies & tools on hand	$25,000	
Other items	33,000	
Labor and const. lumber	40,000	
	$98,000	
Average annual		32,500
Total average annual earnings		$339,000

3. Sales in 2½ year period aggregated 91,454,177 board feet. An average per annum of about 30,000,000 board feet.

4. Sales per thousand have averaged as follows:

1950	$64.48
1951	57.85
1952	63.21

5. The company has sales offices in Portland, Oregon. It owns two mills, on 44 acres, near Fortuna, Calif., about 16 miles south of Eureka.

6. Until December, 1952 operated one with a Swedish gang saw, and a 54" circular saw, which latter has been replaced by a 9 ft. band saw, which has been in operation since Jan. 1st.

7. November and December sales were off seasonally, but the first four months of this year are seasonally good, and Clay Brown expects to cut about 15,000,000 ft. in remainder of the company's fiscal year, at an estimated profit

of $150,000 before taxes. This will bring profit, if realized, to $357,500 for the year.

305 8. The two mills are well planned, and sturdily built. They get their logs both by rail, dumped into their large pond, and by truck, also unloaded at pond edge.

9. Most of the property has a gravel surfacing, with black-top on the roads and on areas where trucks travel from grading shed to yard.

10. Clay Brown cuts only fir—no redwood, since redwood requires large investment due to long air drying period and necessary stocking. There is as much fir in Humboldt County as redwood.

11. Company is represented in Los Angeles by the A. L. Hoover Co., La Brea & Wilshire. They have four salesmen. A. L. Hoover, father; Richard Hoover, son; Robert Hoover, son; Mr. Lieschman in office; and Mr. Boyeer, outside.

12. There are relatively few fir mills in this area of Northern California, and the freight advantage in Southern California is about $6 per M., over Portland, and $2.50 per annum to San Francisco area. This company also enjoys a bulk carload rate, which is an advantage over pound rate from Oregon and Washington.

13. He sells now—70% in So. California; 20% in Bay area; 10% to Texas points. He is aiming at 100% sales in Southern California.

14. He could show a gross of about $250,000 on a cut of 50,000,000 ft. even if he made no profit, but merely sold at same price as competitors and made the freight differential.

15. Earnings of an average of $360,000 would pay out purchase price in five years.

16. Assets as appraised by General Appraisal Co., July 1951, with adjustments for items capitalized, expensed or not included in appraisal, result in net worth of $1,136,156. Six percent interest on deferred balances, assuming an

average of $360,000 earnings per annum, would total $237,112.

Total Worth	$1,136,156
Interest	237,112
	$1,373,268

17. Clay Brown has a good reputation in Portland, Oregon, and generally throughout the lumber and plywood industry. Mr. Carvel Linden of the U. S. National Bank, Portland, stated to me January 14, 1953; "Clay Brown is a top operator. His situation is clean. I have advised him, solely because of his tax burden, to sell to you if he could come to terms with you. We think that his achievement in starting this lumber company, and producing and selling profitably the first month, and 26,400,000 ft. the first year at a net profit before taxes of $415,553, is a real achievement."

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306 CLAY BROWN & Co.

Directors & Officers

Mr. Clay Brown, President & Director
Mr. Clarence Hill, Vice President-resident manager & director
Mr. Don L. Brown, Ass't vice president-Ass't manager & director
Mr. C. W. Booth, Secretary-treasurer & director
Mrs. Dorothy E. Brown, Director

Mr. Clay Brown—President

Director—West Coast Lumbermens Ass'n
Director—Clay Island Inc.
Formerly director—U. S. Plywood & Subsidiaries 1943-1945
Formerly vice president—U. S. Plywood & Subsidiaries
President and director of Tekwood (subsidiary of U. S. Plywood)
Long Bell Lumber Co.—1926-1932 (various capacities)
M & M Company, Portland—Sales Manager—1932-36

Vice President of Ralph L. Smith Lumber Co. 1036-43
(Missouri Corp.) In charge of West Coast operation
Humboldt Plywood Co.—president & director
Sold in 1948
President and general manager to Sept. 1948
Company sold for $1,250,000
Clay Brown Co. in wholesale lumber business to 1950

Mr. Clarence Hill—Vice president and resident manager

Various capacities in Squimm, Washington
Long Bell Lumber Co.—various capacities
Miles Lumber Co.—vice president & director
Wholesale lumber business in Kansas City
Humboldt Plywood Co.—1945—vice president
Clay Brown & Co.—1950

Mr. C. W. Booth—Secretary-Treasurer

Commercial Credit Corp.—1936
Humboldt Plywood Co.—Treasurer
Merchant Marine—1943-45
1948—secretary-treasurer of this company

Mr. Don L. Brown—Assistant vice president & Ass't manager

Oregon State College
Since 1949—with Clay Brown & Co.

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307 ASSETS

Appraisement survey of Clay Brown & Company, bringing appraisal up to December 31, 1952, by General Appraisal Company.

Appraisement	$ 836,759
Circular Saw	1,500
Supplies on hand	25,000
Land—42.38 acres @ $1,500	63,570
Timber, less depletion	123,000
Furniture & Fixtures—Portland & San Francisco	10,376
Auto	2,000
	$1,062,205

November 3, 1954

Mr. Clay Brown,
U. S. National Bank Building,
Portland 4, Oregon.

Re: *California Institute for Cancer Research*

Dear Mr. Brown:

In our review of current tax developments we have kept in mind the lease and license agreement dated February 4, 1953 between the California Institute and Fortuna Sawmills, Inc., together with the agreement dated February 4, 1953, between the California Institute as buyer, and you, acting for yourself and for the other stockholders of Clay Brown & Co., as seller. A recent ruling published by the Bureau of Internal Revenue should be of particular interest to you. A copy of this ruling is attached (Rev. Rul. 54-420, 1 R.B. 1954-39, 5 C.C.H. Paragraph 6432—9/29/54).

You will note that the ruling outlines, without mentioning names, an arrangement identical in all major respects to your sale of Clay Brown & Co., stock to the Institute and the lease agreement between the Institute and Fortuna Sawmills, Inc.

The portion of the ruling relating to the exempt status of the charitable institution is not particularly pertinent since there is little doubt that the Institute is otherwise exempt under Sec. 101 (6) of the code and the Instiute is not subject to Sec. 3814 of the code which denies exemption to certain organizations under certain circumstances. However, the portions of the ruling which we have underlined are significant to your situation. Considering first the last sentence of the ruling, it is the position of the Bureau that in an arrangement such as the one existing between you, the Institute, and Fortuna Sawmills, Inc., the amounts received by the selling stockholders from the charitable institution will not be recognized as proceeds from a sale requiring capital gains treatment. If the Bureau is able to substantiate such a contention, the gain realized by you upon the sale of the stock of Clay Brown & Co. would be taxed as ordinary income rather than as capital

gain. We doubt that the Bureau will be able to substantiate such a contention, especially if your management contract with Fortuna Sawmills, Inc., is eliminated. However, it is advisable to avoid a controversy with the Bureau if
309 possible, and we believe the suggestions hereafter made in regard to revision of the lease will help in this respect.

Perhaps the mose significant portion of the ruling from your viewpoint is the last sentence of the second from the last paragraph which relates that payments labeled as rent in the lease arrangement will not be recognized as rent for purposes of the exemption in Sec. 422 (a) of the code if such payments are in reality a return of profits by a person or corporation operating the property for the benefit of the tax-exempt organization, or if such payments are a share of the profits retained by the tax-exempt organization as a partner or a joint venture. The inference is that the payment of 80% of net profits will not be recognized by the Bureau as rent in spite of the designation of such payments as rent in the lease agreement. If the payments do not qualify as rent, then the 80% of the net profits received by the California Institute will be taxed to it. We understand that taxation of the rental payments to the Institute would force the Institute to default in its payments to you for the stock of Clay Brown & Co.

If the 80% of the net profits payable by Fortuna Sawmills, Inc., to the Institute under the lease is a fair rental for the use of the leased property, then we believe that the Bureau will have a difficult time in substantiating the contention that such payments are not rental and therefore should be taxed to the Institute. As you may recall, when the proposal of the Institution was first submitted to you we prepared an eleven-page memorandum giving our opinion in regard to the tax consequences of the arrangement. The first paragraph of our summary in the memo on pages 10 and 11 reads as follows:

> "SUMMARY: In summary of the foregoing, we are of the opinion that there is a possibility the 80 per cent of the profits to be paid by the new corporation to the Institute in the form of rental might be taxed to the Institute. Therefore, if the deal is premised upon such rental payments being exempt when received by the

Institute, we would advise that a ruling be obtained from the Treasury Department. Also, some provisions should be made as to what would happen if the law should change in the future so as to subject such rental payments to taxation if they are exempt under the present law."

We discussed the possibility of obtaining a ruling from the Treasury Department with Mr. Paul R. Coté, counsel for the Institute. He informed us that he had determined from his dealings with the Bureau that they would not give rulings on the arrangement, but that it was his understanding the Bureau would not upset or question such arrangements.

310 A change of the Bureau's attitude seems to be indicated by the ruling. Not only has the Bureau made a formal ruling, but its conclusions are adverse to the tax consequences desired by you and the Institute.

It would seem from the ruling that there must be a considerable number of other such arrangements which follow a definite pattern identical to your arrangement with the Institute. It seems to be a standard provision that the operating company will pay as rental and royalty an aggregate of 80% of the net profit of the operating company before taxes. We understand that such arrangements cover a variety of other businesses in addition to sawmills. A serious doubt would seem to exist as to whether 80% of net profits can constitute a fair rental in all instances. As before stated, we believe the success of the Bureau's attempt not to recognize the payments as rental for purposes of Sec. 422 (a) depends to a large extent upon the fairness of the rental. While 80% of the net profit may be a fair rental for Fortuna Sawmills, Inc., it may be difficult to convince the Bureau of this in view of the numerous other instances in which a similar contention will be made in regard to other assets. If it is not logical to suppose that 80% of the net profits is a reasonable rental in all of the similar arrangements, then you can expect a rather cold reception from the Bureau when you contend that the payment of 80% of the net profit by Fortuna Sawmills, Inc., is a fair rental.

We believe your position can be materially strengthened if the lease and license agreement is amended in such manner as to provide for a rental which is not the same as that followed in the other similar arrangements. The easiest rental to substantiate wouud be a flat amount per month, but this is obviously impracticable. The next best thing is to base the rental upon the quantity of lumber manufactured by Fortuna Sawmills, Inc. We asked you what you as an experienced lumberman, would be willing to pay per thousand feet of lumber manufactured for use of sawmill facilities similar to those of Fortuna. You answered that $5.00 per thousand should be a very fair rental. Mr. Booth has projected the amount of the rental based upon $5.00 per thousand as compared to the rental accrued under the present terms of the lease. This is set forth on the attached schedule. It shows that the rental based on $5.00 per thousand would be substantially more for the short fiscal year ended April 30, 1953 and for the full fiscal year ended April 30, 1954. The rental at $5.00 per thousand for the first five months of the current fiscal year is less than the rent accrued under the present formula. An estimate of busines for the balance of the fiscal year shows that the rent at $5.00 per thousand will be a little more than under the present formula, giving a total rental for the current fiscal year at $5.00 per thousand which is $61,905.02 less than the rental generated under the present formula ($338,579.24 under the present formula minus $276,674.22 at $5.00 per thousand). The $61,905.02 deficiency is substantially less than the excess of the rental at $5.00 per thousand for the previous years which could be carried over to the current fiscal year.

The last line of the enclosed schedule shows that the rental for the period February 1, 1953 to April 30, 1955, would be $558,762.17 at $5.00 per thousand as compared to $383,021.61 under the present formula. This gives an excess of rental at $5.00 per thousand over rental under the present formula of $175,740.56 which could be carried over to the remaining fiscal years under the lease. If the future years are as good and no better than the anticipated current fiscal year, the before-mentioned carry-over of $175,740.56 would be sufficient to make up the amount by which the rental at $5.00 per thousand for such future years

would be less than the rental generated under the present formula.

The foregoing suggests the possibility of amending the lease to provide for rental at $5.00 per thousand feet of lumber manufactured by Fortuna Sawmills, Inc., subject to the limitation that such rental payments for any fiscal year cannot exceed 80% of net income, with any excess or rental at $5.00 per thousand over the 80% of net income limitation to be carried over to future years subject to the before-mentioned 80% limitation in the future years. While the amendment could be made as of April 30, 1954, it would provide that the rental for the prior years and the carry-over would be computed just as if the amendment were in effect from the inception of the lease. The rental for the fiscal year ended April 30, 1953 and the fiscal year ended April 30, 1954 would be the same under the amendment as under the present formula because the 80% of net profit limitation applies in view of the fact that such 80% is less than the rent computed at $5.00 per thousand. There would then be carried over to the current fiscal year the excess of the rent computed at $5.00 per thousand over the 80% of net profit limitation. This carry-over would permit as much rental to be paid at $5.00 per thousand as would be paid under the present formula since the rental at $5.00 per thousand for the current fiscal year plus the carry-over from the preceding years is greater than the 80% of net profit limitation. There is even the above-mentioned $175,740.56 carry-over to fiscal years after April 30, 1955.

Amendment of the lease in accordance with the foregoing would not result in any less rental up through the current fiscal year and will not result in any less rental for the remaining term of the lease unless Fortuna Sawmills, Inc., does substantially better in the future years than during the current year. In view of the favorable effect of the strike this year, it seems unrealistic to expect that future years will be any better than the current one. Even if Fortuna Sawmills, Inc. should do substantially better
312 in the future years so that less rental will be payable at the rate of $5.00 per thousand than under the present formula, we believe the advantages to be gained are worth any such possible deficiency in rental.

The fact that rental at $5.00 per thousand generates an amount approximating the rental payable under the present lease seems to indicate the reasonableness of the rental provision under the present lease. On the other hand, the similarity of the two rentals may be attributed to the reduced profits in the previous years which gives a substantial carry-over to subsequent years. Even if the rental at $5.00 per thousand generates an amount approximating what is payable under a rental of 80% of net income, and even though such may be interpreted as proof that 80% of net rental is fair, we believe there are advantages to amending the lease along the suggested lines. Rental at $5.00 per thousand feet on lumber manufactured in the mill is easier to substantiate as a reasonable rental arrangement, especially in view of your statement that it should be possible if the need arises to obtain testimony from competent lumbermen that such is a reasonable rental. Also, such a rental arrangement differs from the procedure outlined in the Bureau's ruling. We believe there is considerable advantage in having a rental agreement which does not follow the more or less standardized form of 80% of net profits. Limiting rentals at $5.00 per thousand to a ceiling of 80% of net profits with a carry-over provision should not detract from the fact that the lease amended along the suggested lines would primarily and basically be a lease providing for rental of a flat amount per unit of production, rather than rental based entirely on a percentage of net income. Where the rental is not based primarily on a percentage of income, it is much more difficult for the government to contend that the so-called rental payments are a return of profits by a company operating the property for the benefit of the tax-exempt organization, or to contend that the payments are a share of profits retained by the tax-exempt organization as a partner or a joint venturer.

We strongly recommend that the lease between Fortuna and the Institute be amended as suggested above. The lease should also be amended to eliminate the requirement of a management contract with you. Your recent acceptance of a position with M. & M. makes such an amendment necessary even if it were not considered advisable for tax purposes.

Before anything more can be done to carry out our suggestions, it will be necessary to obtain the approval of the California Institute. Two extra copies of this letter are enclosed which you may forward to the Institute in
313 requesting the suggested change. We understand that a payment will be due under the lease in the near future and we strongly advise that any amendment be accomplished in time so that such payment may be made under the revised lease, even if it is necessary to hold up the payments.

Since the revision of the lease should be for the mutual benefit of you and the Institute, we do not anticipate any objection from the Institute. When you have obtained their approval and received information as to who will handle the revision on their behalf we shall be glad to get together with them either here in Portland or in Los Angeles as soon as possible. If, for any reason, the Institute should not desire to go along with the suggested changes, then we believe that before making the next rental payment you should receive assurance from them that they will pay any taxes assessed against them on the rental from other sources of income so that you will receive the full amount upon the purchase price for your stock as specified in the stock sales agreement.

Very truly yours,

WILLIAM H. KINSEY
William H. Kinsey

WHK AML
Encl.

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Analysis of Rent as accrued at 80% of earnings (before rent and taxes) compared with rent which would have accrued at $5.00 per M' of shipment

Period Covered	Footage Shipped	Earnings before rent and taxes	Rent as accrued	Rent which would have accrued @ $5.00 per M' shipped
Fiscal Year ended 4/30/53 (3 mos)	10,304,767'	$ 46,206.91	$ 36,965.53	$ 51,523.84
Fiscal Year ended 4/30/54 (12 mos)	46,112,821'	(4,748.23)	7,476.84*	230,546.11
Current Fiscal Year to date (5 mos)	27,334,843	294,463.84	226,579.24	136,674.22
Balance Fiscal Year to 4/30/55 (estimated)	28,000,000	140,000.00	112,000.00	140,000.00
Total Fiscal Year ended 4/30/55	55,334,843	434,463.84	338,579.24	276,674.22
Total All Years, 2/1/53 to 4/30/55	111,752,431	$475,922.52	$383,021.61	$558,762.17

* Overpayment—adjusted following year.

315 **Exhibit 58-FFF**

Memo to Clay Brown
from Wilbur, Mautz, Souther & Spaulding

Re: Proposal of California Institute for Cancer Research

You have asked our opinion in regard to the proposal of the Institute to purchase the stock of Clay Brown & Company. From the information you supplied us we understand that the essentials of the proposal are as follows:

1. The Institute will purchase all of the stock of Clay Brown & Company for X Dollars. One Hundred Thousand ($100,000) Dollars of the purchase price will be paid down with the balance to be evidenced by a promissory note secured by real and chattel mortgages on the assets of Clay Brown & Company received by the Institute upon the liquidation of the Company.

2. Clay Brown & Company will then be dissolved and the Institute will receive all the assets thereof upon dissolution.

3. The $100,000 down payment will be made from the assets received by the Institute on liquidation.

4. Although not mentioned in the information you supplied us, we assume that the liability of the Institute to pay the balance of the purchase price for your stock will be limited to the income it realizes from the assets of Clay Brown & Company received by it on dissolution.

5. The Institute will not operate the business itself, but instead will:

(a) Sell the current position to a new corporation for which the Institute will receive the note of the new corporation.

(b) Lease the balance of the assets to the new corporation under a lease providing for the payment to the Institute of rental equal to 80 per cent of net income of the new corporation before taxes.

6. The Institute will retain 10 per cent of the rent received by it from the new corporation, and will apply the balance (90 per cent) upon the unpaid purchase price for the stock.

7. The new corporation will be capitalized for $25,000 of which you buy 45 per cent of the stock and your friends (not family) purchase the balance.

8. You will be employed by the new corporation as general manager.

316 9. The proposal does not state over what period of time the balance of the purchase price is to be paid but we understand five years has been mentioned. We assume that the lease of the assets by the Institute to the new corporation will be for a period of not more than five years.

We understand that the proposal is based upon the assumption that the following income tax consequences

will be derived from the plan, and therefore the advisability of the plan depends upon the validity of these assumptions:

(a) The price you receive for your stock of Clay Brown & Company (the original down payment plus the subsequent payments) will be capital gain to you, and that you will be able to report such capital gain upon the installment basis.

(b) The new corporation will be able to deduct for income tax purposes the rental (80 per cent of net income before taxes) paid to the Institute under the lease, and such rental payments received by the Institute will be exempt and not subject to income tax.

The validity of assumption (a) above is of primary importance to you. The validity of assumption (b) is more a problem of the Institute but nevertheless is of importance to you since it vitally affects the ability of the Institute to pay the balance of the purchase price for the stock. There follows a review of our opinion concerning the beforementioned tax assumptions.

(a) *Will you be entitled to capital gain treatment and to report such gain on the installment basis?*

Under the proposal you will be selling your stock in Clay Brown & Company which you have held for more than six months, so it would seem that you should be entitled to report as a long term capital gain the amount received by you upon the sale of the stock. If this is so, you should be able to report such gain on the installment basis. The problem then is to determine whether there is any theory under which the Commissioner might contend that there was not a sale of the stock entitling you to capital gain treatment. A point of possible attack is the reorganization provisions of the Internal Revenue Code. If you acquire 80 per cent or more of the stock of the new
317 corporation there would be a definite danger that there might be what is known as a Clause (D) reorganization under Section 112 of the Code. If there is

such a reorganization, either of two dangerous consequences would result:

(a) The gain received by you upon the sale of the stock could not be reported on the installment bases and all of the gain would be taxed to you in the year of sale.

(b) Worse yet, the portion of the gain not in excess of the accumulated profits of Clay Brown & Company would be taxed to you as a dividend under I.R.C. Sec. 112(c)(2).

As before stated, the danger is substantial if you acquire 80 per cent or more of the stock of the new corporation. Exactly why this is true involves the intricacies of the reorganization provisions of the Code and we will be glad to explain them to you further if you so desire. We realize that the proposal provides that you will own only 45 per cent of the stock of the new corporation and that the balance will be acquired by your friends. The danger here is that if it could be successfully contended that your friends really held the stock for you, then it would be the same as if you owned it. Stock owned by your wife or children is also considered as stock owned by you.

If more than 20 per cent of the stock of the new corporation is definitely owned by independent third persons, will be the foregoing dangerous tax consequences be eliminated? We believe there is a good chance they would be eliminated but to be on the safe side we would prefer that you owned no stock in the new corporation whatsoever. In short, the proposal has tax dangers unless you are resigned to the fact that the new corporation which will operate the business will be controlled by independent third persons and that you will be unable to control same either directly or indirectly. You may have a management contract with the new corporation, but you should realize that it could be terminated by the new corporation at any time leaving you with whatever action you may have for damages against the new corporation. Your continuance as manager of the new corporation should not be a condition of the sale of the stock by you to the Institute.

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The more the deal is a straight sale of the stock of Clay Brown & Company by you, the better your tax position. It is all right if the down payment is obtained from the assets of Clay Brown & Company received upon dissolution, and if the unpaid balance is secured by real and chattel mortgages on the assets. Likewise it is all right if the payment of the unpaid balance is limited to moneys received by the Institute in the operation of the business. None of these features conflict with an outright bona fide sale of the stock by you. The danger arises when you maintain an interest in the operation of the business for reasons other than security for the unpaid balance of the purchase price for the stock. Your acquisition of a stock interest in the new corporation seems to have little connection with security for the purchase price. The management contract has more of a relationship to security since you have a definite interest in the management of the business inasmuch as the payment of the balance of the purchase price for your stock is limited to payment from income realized from the business. However, your being general manager gives you certain control over the new corporation which might be considered to be the same as control through stock ownership. This danger is minimized if the management contract does not extend beyond the full payment of the purchase price for the stock, and if the management contract is not tied in as a definite condition in the sale of the stock. The sale of your stock could be conditioned merely upon the furnishing of management for the business satisfactory to you until the stock is fully paid for. The management contract should be a separate contract between the new corporation and you.

If our suggestions are followed, your only security for the unpaid balance of the price for your stock would
319 be the real and chattel mortgages. These mortgages would not cover what is referred to as the "current position" in the Institute proposal. We assume the current position means the excess of current assets (including inventory) over current liabilities. It would be best, of course, if the down payment for the stock could equal this current position so that it would not be necessary to secure payment for same, and the real and chattel mortgages would be sufficient security to cover the unpaid balance of

the purchase price. If the down payment cannot be this much, then under the Institute proposal the new corporation would give its note to the Institute for the current position and this note in turn would be deposited with you as additional security for the unpaid balance of the purchase price. Such unsecured note of the new corporation is not too good security so it probably would be necessary to have the stock of the new corporation deposited in escrow as security for the note of the new corporation and this stock could be in turn assigned to you by the Institute together with the note. We would prefer some other type of security for the current position which would make it unnecessary for you to have the stock of the new corporation even as additional security. Such security might take the form of an assignment of accounts receivable.

In summary, we believe that under the present federal income tax law you should be entitled to capital gain treatment on the sale of your stock under the Institute proposal, particularly if you own no stock whatsoever in the new corporation. If you purchase no stock of the new corporation, there may be a problem as to how the new corporation will be capitalized. Any funds required by the new corporation over and above the amounts paid for its stock by the independent stockholders could be obtained by a bank loan. It might be necessary for you to
320 guarantee such loan. We would rather have you guarantee a bank loan than have you make a loan directly to the new corporation.

We are familiar with an instance here in Portland where stock in a business was sold to an institution under a setup quite similar to that proposed to you. The selling stockholders obtained approximately a thirty per cent stock interest in the new lessee corporation. This deal was consummated just a little over a year ago so it has not been reviewed by the Treasury Department. In the absence of definite approval by the Treasury Department either through a special ruling or by approval of a similar deal, we advise that you do not own any stock in the new corporation.

Will the rental be fully deductible by the new corporation and exempt when received by the Institute?

We understand that the feature which makes the proposal of the Institute possible is the fact that the new corporation will be able to deduct the rental payments paid the Institute but yet such rental payments will be exempt from taxation when received by the Institute. If it were not for this tax exemption status of the Institute, the deal could just as easily be worked out without the Institute. For example, some third persons could organize a new corporation and have the new corporation purchase all of your stock in Clay Brown & Company, dissolve Clay Brown & Company, make a down payment on the stock out of the assets received upon dissolution, and pay the balance out of the profits secured by real and chattel mortgages. Such new corporation would not be able to deduct the payments made on the purchase price for the stock, so the profits used to pay the purchase price would be subject to income taxes.

321 As before stated, the advantage of the Institute proposal is that the profits used to pay the balance of the purchase price for the stock is supposedly never subjected to income taxes. This is accomplished by having 80 per cent of the profits of the new corporation paid to the Institute in the form of rent. Such rent will be deducted by the new corporation and therefore will not be taxed to it. Rent deducted by the lessee does not escape taxation if the rent is taxable to the lessor as is the case involving an ordinary lessor. However, if the lessor is tax-exempt and the rent is not taxed to it, then the rent (and the profits with which it was paid by the lessee) is never subject to income tax. We understand that the Institute's proposal is based upon the assumption that the rent will be deductible by the new lessee corporation but the income tax exemption of the Institute will preclude taxation of such rent when received by the Institute.

Is there any reason to doubt the tax exemption assumptions mentioned in the preceding paragraph? First, the Commissioner might contend that the 80 per cent of the net profit payable by the new corporation is not really rent. There might be some merit to this contention if 80 per

cent of the profit is more than what a reasonable person would agree to pay as rental for the assets under arms length bargaining. Second, the Commissioner might contend that the rental payments received by the Institute are subject to income taxes on the theory that such income is "unrelated business net income" which is subjected to income taxes under amendments to the income tax law accomplished by the Revenue Act of 1950. The Commissioner probably would not argue that the rental is not deductible by the new corporation and also that such rental is taxable to the Institute, although there might be some possible theory under which this contention could be made. More likely the Commissioner would argue either one or
322 the other, whichever one he thought offered the greatest possibility of success.

In our opinion the Commissioner will be most likely to argue that the rental payments received by the Institute are taxable to it under I.R.C. Sec. 421 which imposes a normal tax of 30 per cent of Supplement "U" net income and a surtax of 22 percent of Supplement "U" net income in excess of $25,000. The Supplement "U" net income is defined to be the amount by which the Institute's unrelated business net income exceeds $1,000. In other words, if the rental payments received by the Institute constitute unrelated business income, such rentals after deduction for depreciation, etc. are taxable to the Institute at the same rate as the normal and surtax applicable to ordinary corporations (except for the $1,000 exemption).

Would the rental payments constitute unrelated business income? Such rental payments are certainly unrelated to the regular business of the Institute, so it would be subject to tax unless covered by a specific exclusion. Exclusion from unrelated business net income are contained in the subparagraphs of Section 422. One of the exemptions covers rents from real property (including personal property leased with the real property), except for rental from a Supplement "U" lease. Another exemption excludes royalties and contains the phrase "whether measured by production or by gross or net income from the property". The exclusion applicable to rentals does not contain such a provision which might lend substance to the inference that excluded rentals does not include payments based on

a percentage of net income such as the rentals which would be payable by the new corporation to the Institute.

In the instance which we referred to above where a Portland business was sold under a similar deal, some patents were involved so the payments to the institution there involved included royalties as well as rents.
323 As above noted, royalties are excluded from unrelated income even though measured by net income. This may or may not be true of rentals.

Also to be considered is whether the rental would be rental from a Supplement "U" lease. As before stated, if the lease from the new corporation to the Institute is a Supplemental "U" lease, then the rentals thereon received by the Institute would be unrelated income and subject to tax. A Supplement "U" lease is defined in Sec. 423 to be a lease for a term of more than five years where an indebtedness was incurred by the lessor in acquiring or improving the property leased.

The Institute would incur an indebtedness to you for the assets leased to the new corporation, so the lease would be a Supplement "U" lease if it is for a term of more than five years. In computing the term of a lease which contains an option for renewal or extension, the term of such lease shall be considered as including any period for which such option may be exercised. Therefore the lease from the Institute to the new corporation cannot be for a period of more than five years including any options for renewal. Even if there was no express option for renewal if the deal had circumstances which made it very incumbent upon the lessor to extend the lease such might be interpreted as being an option of renewal. If the lease from the Institute to the new corporation is for not more than five years, there is still the above-mentioned possibility that the rental would be unrelated income and subject to tax when received by the Institute.

The Institute has undoubtedly had some research done on this question and may have some rulings from the Commissioner. The law is relatively new so there are no cases as yet. Based purely on a reading of the statute and the applicable regulations which do little more than paraphrase the statute, we believe there is a serious question of
324 whether the rentals received by the Institute from the new corporation would be subject to tax.

If the rentals are subject to tax when received by the Institute, how will this effect the deal? Would the Institute nevertheless have to pay to you 90 per cent of the rent received and pay the taxes thereon out of the 10 per cent of the rent to be retained by the Institute plus any other funds of the Institute necessary to make up the tax? Or would such taxes reduce the 90 per cent payable to you? On the other hand the taxes might be paid out of the rentals received and the amount remaining after taxes would be distributed 90 per cent to you and 10 per cent retained by the Institute. If the 90 per cent is paid to you after taxes, this will reduce the payments and prolong the time it will take to pay up the unpaid balance for your stock. You then would not be in a much better position than if you sold your stock to an ordinary corporation formed for the purpose of purchasing your stock and taking over the assets upon liquidation.

Since the proposal of the Institute assumes that there will be no taxes payable by it on the 80 per cent of the profits of the new corporation received as rent, the Institute may be willing to agree that 90 per cent of such rent shall be applied against the purchase price for the stock before any income taxes which might be assessed. In any event, this is a point to be covered with the Institute. If the Institute is not willing to absorb any taxes which might be assessed on the rentals recevied by it from the new corporation, we would advise that you do not enter into the deal without first having obtained a definite ruling from the Treasury Department that such rentals would not be taxed to the Institute. As before stated, the Institute may already have obtained such a ruling.

Summary

In summary of the foregoing, we are of the opinion that there is a possibility the 80 per cent of the profits
324a to be paid by the new corporation to the Institute in the form of rental might be taxed to the Institute. Therefore, if the deal is premised upon such rental payments being exempt when received by the Institute, we would advise that a ruling be obtained from the Treasury Department. Also, some provisions should be made as to what would happen if the law should change in the future

so as to subject such rental payments to taxation if they are exempt under the present law.

Assuming that the problem mentioned in the preceding paragraph is met, we believe the deal can be worked out in such manner as to accomplish the capital gain tax results desired by you, but as above mentioned we advise that you acquire no stock interest whatsoever in the new corporation and suggest that the other beforementioned modifications of the Institute's proposal should be made.

There is one more problem that probably should be considered. As before noted, the lease from the Institute to the new corporation cannot be for more than five years and cannot contain an option for renewal. What will happen if the unpaid balance of the purchase price for your stock has not been paid upon the expiration of the five-year lease? It might be provided that if your stock is not all paid for out of the 90 per cent of the rents to be received by the Institute then the obligation to pay the remaining balance shall become a fixed obligation of so much per month or year irrespective of income.

Exhibit 73-UUU

Period Covered	1 Fortuna Net Profit Before Rent and Income Taxes — Semi-Annual	2 Fortuna Net Profit Before Rent and Income Taxes — By Fiscal Years	3 Payments by Fortuna To Institute Per Lease and License Agreement — 80% of Net Profit — Semi-Annual	4 Payments by Fortuna To Institute Per Lease and License Agreement — 80% of Net Profit — By Fiscal Years	5 Payments by Fortuna To Institute Per Lease and License Agreement — Other	6 Payments by Institute on Promissory Notes — Applied on Brown Notes	7 Payments by Institute on Promissory Notes — Applied on Stock
Feb. 4, 1953 (down payment)						3,637.50	1,362.50
Feb. 4, 1953 to April 30, 1953	46,206.91		36,945.53			25,050.74	8,200.24
Total, fiscal year ended 4/30/53		46,206.91		36,945.53			
May 1, 1953 to Oct. 31, 1953	9,346.05		7,496.84		1,796.08(1)	6,407.43	2,135.81
Nov. 1, 1953 to Apr. 30, 1954	⟨ 14,094.28 ⟩				5,285.90(2)	3,964.42	1,321.48
Total, fiscal year ended 4/30/54		⟨ 4,748.23 ⟩		7,496.84			
May 1, 1954 to Oct. 31, 1954	347,516.66		150,000.00			85,939.91	49,060.09
Nov. 1, 1954 to Apr. 30, 1955	174,068.50		246,019.61		4,098.00(3)		225,515.65
Total, fiscal year ended 4/30/55		521,585.16		396,019.61			
May 1, 1955 to Oct. 31, 1955	263,010.45		100,000.00		1,450.00(4)		91,450.00
Nov. 1, 1955 to Apr. 30, 1956	68,857.39		163,387.55				147,048.80
Total, fiscal year ended 4/30/56		331,867.84		263,387.55			
May 1, 1956 to Oct. 31, 9156	118,610.47						
Nov. 1, 1956 to Apr. 30, 1957	⟨ 125,346.89 ⟩		142.50*				
Total, fiscal year ended 4/30/57		⟨ 6,736.42 ⟩		142.50*			
SUB-TOTALS	888,175.26	888,175.26	703,992.03	703,992.03	12,629.98	125,000.00	526,094.57
May 1, 1957 to Oct. 31, 1957	⟨ 83,681.21 ⟩						
Nov. 1, 1957 to Apr. 30, 1958					20,849.29(5)		20,849.29
May 1, 1958 to Oct. 31, 1958					989.00(6)		989.00
Nov. 1, 1958 to Apr. 30, 1959							
May 1, 1959 to Oct. 31, 1959					1,102.50(7)		1,102.50
					35,570.77	125,000.00	549,035.36
					Plus paid on Brown Notes		125,000.00
							674,035.36
					Proceeds of sale to California Highway Dept.		262,096.49
					Total paid by Institute on Promissory Note and Brown Notes		936,131.85
					Total Promissory Note		1,300,000.00
					Less Payments		936,131.85
					Unrecovered on Promissory Note		363,868.15

* 142.50 erroneously overpaid rent--later corrected. See Item (5).

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Notes applicable to Column 5

(1) Workmens' Compensation Dividend for Industrial Indemnity Company for period Dec. 1, 1950 to Dec. 1, 1951		1,796.08
(2) Workmens' Compensation Dividend for period Dec. 1, 1951 to Dec. 1, 1952	84.23	
Proceeds from sale of capital assets	5,201.67	5,285.90
(3) Proceeds from sale of capital assets		4,098.00
(4) Proceeds from sale of capital assets		1,450.00
(5) Settlement of promissory note given by Fortuna to the Institute representing excess of current assets over current liabilities	20,991.79	
Less overpayment of rent for fiscal year ended 4/30/57	142.50	20,849.29
(6) Proceeds from sale of capital assets		989.00
(7) Proceeds from granting right-of-way across mille premises to Pacific Gas & Electric Co.	247.50	
Sale of capital assets	855.00	1,102.50
		35,570.77

Exhibit 32-DDDD

327 CLAY BROWN & COMPANY

BALANCE SHEET
January 31, 1953, and

STATEMENT OF EARNINGS AND RETAINED EARNINGS
Nine Months ended January 31, 1953

ACCOUNTANTS' REPORT

328 PEAT, MARWICK, MITCHELL & CO.
AMERICAN BANK BUILDING
PORTLAND 5, OREGON

ACCOUNTANTS' REPORT

The Board of Directors
Clay Brown & Company

We have examined the balance sheet of Clay Brown & Company as of January 31, 1953 and the related statement of earnings and retained earnings for the nine months then

ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The cash and bank balances have been confirmed by count or by confirmation obtained direct from the depositaries.

We issued requests to customers for confirmation of accounts receivable comprising approximately 98% of the total. All exceptions reported were explained to our satisfaction. The notes and accounts receivable from customers and others were reviewed as to age and collectibility and, in our opinion, reasonable provision has been made for probable losses.

Of the total log inventory, logs having a carrying value of $376,491.66 are stated in accordance with warehouse receipts issued by the Lawrence Warehouse Company, which has physical custody of logs pledged as collateral security to the bank. The remainder of the log inventory and lumber quantities are stated in accordance with physical inventories taken by employees of the company. The inventories were valued by employees of the company under direction of the management and we obtained a certificate from an official of the company as to their description, quantities, condition and valuation. As to the warehoused logs, we relied as to the quantities on a certificate obtained directly from the warehouse company after making such supplemental inquiries as we deemed necessary. We made tests of the physical existence of the quantities of certain items selected by us and observed the inventory taking in reference to the lumber and that portion of the log inventories not warehoused. Logs and lumber are stated at the lower of average cost or market and we tested the prices and computations, satisfying ourselves as to the general basis of valuation.

329 Expenditures charged to the property, plant and equipment accounts during the period, in our opinion, were properly capitalized as representing additions and improvements. The allowance for depreciation for the period appears to be reasonable.

In our opinion, the accompanying balance sheet and statement of earnings and retained earnings present fairly the financial position of Clay Brown & Company at January 31, 1953 and the results of its operations for the nine months then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & Co.

Portland, Oregon
April 7, 1953

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CLAY BROWN & COMPANY

BALANCE SHEET

January 31, 1953

ASSETS

Current assets:		
Cash		$ 30,738.41
Accounts and notes receivable, less allowance for doubtful accounts:		
Accounts receivable—trade	$115,493.60	
Sundry accounts and notes receivable	4,162.60	
	119,656.20	
Less allowance for doubtful accounts	2,323.44	117,332.76
Inventories—at the lower of average cost or market (note 1):		
Logs (logs carried at $376,491.66 pledged as security for bank loan, per contra)	419,375.11	
Lumber	38,737.33	458,112.44
Prepaid expenses:		
Insurance	9,388.37	
Falling and bucking costs	1,543.74	10,932.11
Total current assets		617,115.72
Plant and equipment—at cost less depreciation:		
Fortuna, California plant (note 2):		
Land	24,635.27	
Buildings	173,520.45	
Equipment and facilities	415,379.26	
Automotive equipment	21,738.63	
Furniture and fixtures	5,057.81	
Total Fortuna, California plant	640,331.42	
Sales offices—automobile and furniture	14,328.62	
	654,660.04	
Less accumulated allowance for depreciation	108,743.98	545,916.06
Timber—at cost, less depletion		47,549.78
Deposits		51.00
		$1,210,632.56

See accompanying notes to financial statements, which are an integral part of this statement.

January 31, 1953
BALANCE SHEET
CLAY BROWN & COMPANY

LIABILITIES

Current liabilities:			
Demand notes payable to bank (secured by pledge of logs carried at $376,491.66, per contra)			$ 269,265.00
Portion of long-term debt due within one year (note 2)			43,531.31
Accounts payable—trade			32,263.30
Accrued payroll, taxes, interest, etc.			28,114.05
Federal taxes on income:			
Final installment—preceding year		$ 10,109.06	
Estimate for current year		116,280.92	126,389.98
Total current liabilities			499,563.64
Long-term debt, exclusive of notes payable to stockholders (note 2):			

	Total	Current portion	
Timber purchase contract	$ 32,541.46	2,581.32	
Mortgage note payable to bank	100,871.09	39,219.94	
Deferred insurance premiums	1,730.05	1,730.05	
	135,142.60	43,531.31	91,611.29
Demand notes payable to stockholders (subordinated to mortgage note payable—note 2)			125,000.00
Stockholders' equity (note 3):			
Common capital stock of $1.00 par value per share, authorized 50,000 shares; issued and outstading, 32,000 shares		32,000.00	
Capital surplus (no change during period)		13,986.00	
Retained earnings		448,471.63	
			494,457.63
			$1,210,632.56

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CLAY BROWN & COMPANY

STATEMENT OF EARNINGS AND RETAINED EARNINGS

Nine Months ended January 31, 1953

Net sales	$2,089,786.82
Cost of sales	1,696,628.28
	393,158.54
Earnings of wholesale department	448.11
Gross income	393,606.65
Selling, general and administrative expenses	166,722.03
Operating earnings	226,884.62
Other income	1,038.83
	227,923.45
Interest on notes payable	14,697.91
Earnings before Federal Taxes on income	213,225.54
Federal taxes on income (including $15,198.67 excess profits tax)	116,550.01
Net earnings	96,675.53
Retained earnings at April 30, 1952	351,796.10
Retained earnings at January 31, 1953	$ 448,471.63

Note: The allowance for depreciation for the period amounted to $37,228.34, and the allowance for depletion of timber amounted to $28,053.77.

See accompanying notes to Financial Statements, which are an integral part of this statement.

CLAY BROWN & COMPANY

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NOTES TO FINANCIAL STATEMENTS

Note 1. Inventories:

Logs carried on the books at $376,491.66 are stated in accordance with field warehouse receipts. The remainder of the log inventory together with the lumber quantities are stated pursuant to physical inventories.

Note 2. Long-Term Debt:

The timber purchase contract is payable as timber is cut and removed, subject to a minimum quarterly payment of $4,280 less credit for excess cut in prior quarters.

The mortgage note payable to bank is secured by a real and chattel mortgage on the Fortuna, California plant. The note is payable in installments of $1,800 monthly, including interest, and the balance on or before June 15, 1960. In addition to the monthly installments an accelerated payment of principal and interest is payable on June 30 of each year equal to fifty

per cent of the annual net earnings before depreciation and after taxes and after deducting the aggregate amount of principal payments made during the previous fiscal year. The bank, however, has waived this accelerated payment with respect to earnings for the period ended January 31, 1953 and has agreed to accept instead, $3,600 monthly including interest for the twelve succeeding months. The current portion of this loan has, therefore, been computed on that basis. As of February 4, 1953 the Company technically violated the terms of the loan agreement through the dissolution described in Note 3. To date no demand for payment has been made because of the non-compliance with terms of the loan agreement.

The notes payable to stockholders, although payable on demand, have been subordinated to the mortgage note payable to the bank by agreements dated October 29, 1949, and under the terms of said agreements no portion of principal may be paid so long as any portion of the mortgage note to the bank remains outstanding.

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Note 3. Dissolution:

On February 4, 1953, pursuant to approval of its stockholder and resolution of the Directors, Clay Brown & Company was formally dissolved. Upon such dissolution all of the assets and liabilities of the corporation were transferred to the sole stockholder of the Corporation on that date as a liquidating dividened. Immediately thereafter all of the current assets subject to all liabilities, except notes payable to the former stockholders, $125,000.00, were sold and the plant and equipment leased to Fortuna Sawmills, Inc., which company will operate the properties.

Exhibit 84-FFFF

334 January 7, 1953

Mr. C. W. Booth Secretary-Treasurer
Clay Brown & Company
U. S. National Bank Bldg.
Portland 4, Oregon

Dear Mr. Booth:

I am sorry to be so long in answering your letter of December 22nd but the holidays and several absences from the city put me a long way behind in my correspondence.

First of all I received the audited statement of Peat, Marwick, Mitchell & Co., dated April 30, 1952, for which I thank you. I should like, also, to have the supplemental details for that same date in the unaudited form, including the six schedules you mentioned in your letter of December 22nd, which you kindly volunteered to send me.

The ProForma Statement of Assets of October 31, 1952, in which the revised values were substituted, and the item-

ized schedule B, which makes the substitutions entirely clear, were also received and very much appreciated.

As to companies with which deals have been completed, my suggestion is that the one of most interest to you would be that of the White Pine Lumber Company in Reno, Nevada, which was sold to Loyola University and handled by Paul Cote'. Probably you or Mr. Brown know the principals connected with that company.

Another suggestion is the name of Dana Latham, a leading tax attorney in Los Angeles, whose present offices are in the Statler Building, 900 Wilshire Blvd., Los Angeles.

335 He has been familiar with this type of transaction for a good many years, and I believe, with Mr. Cote' handled the sale of the U. S. Grant Hotel, as well as the more recent sale of the Allied Recorder Company. He is also counsel for another company, the name of which I am not yet free to give you but it may be that you or your lawyers would like to contact him and ask him a few questions. I understand from Mr. Cote' that Mr. Souther did talk to him, in particular concerning the ownership of a new operating company.

I am of the opinion that it would be, as you suggest, a good idea to bring the appraisal up to date, if we arrange a basis for a deal. I hope it will not be too expensive. Thank you very much for your careful attention to my requests.

I will not be in the office after Friday, and will be in Portland the fore part of next week, so you may as well hold the supplementary sheets to your company statement of April 30, 1952, and hand them to me when we meet in Portland.

You probably now have the company statement for November 30th and may have some preliminary idea of results for December. These figures, of course, I would like to know though I realize that these months, and December in particular, are off-season and that the earnings for this

half year will probably occur in the first four months of this fiscal year.

Kindest regards.

Sincerely yours,

L. H. SEAGRAVE

LHS:HL
cc: Mr. Clay Brown

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336 January 7, 1953

Mr. Clay Brown
President
Clay Brown & Company
U. S. National Bank Building
Portland 4, Oregon

Dear Mr. Brown:

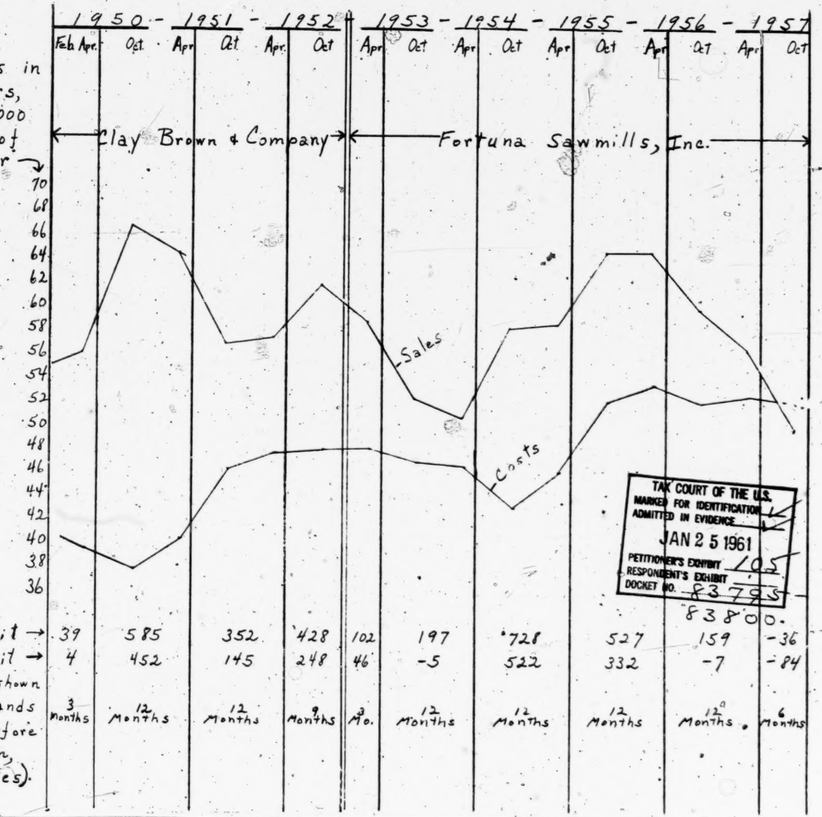
I understand from Mr. Guy Witter that Mr. Boone has arranged for a meeting at your Portland office with you and your lawyer. He sent word that I would be there Tuesday morning at 10:00 o'clock. However, I shall leave here on Friday evening or Saturday as I have several engagements enroute.

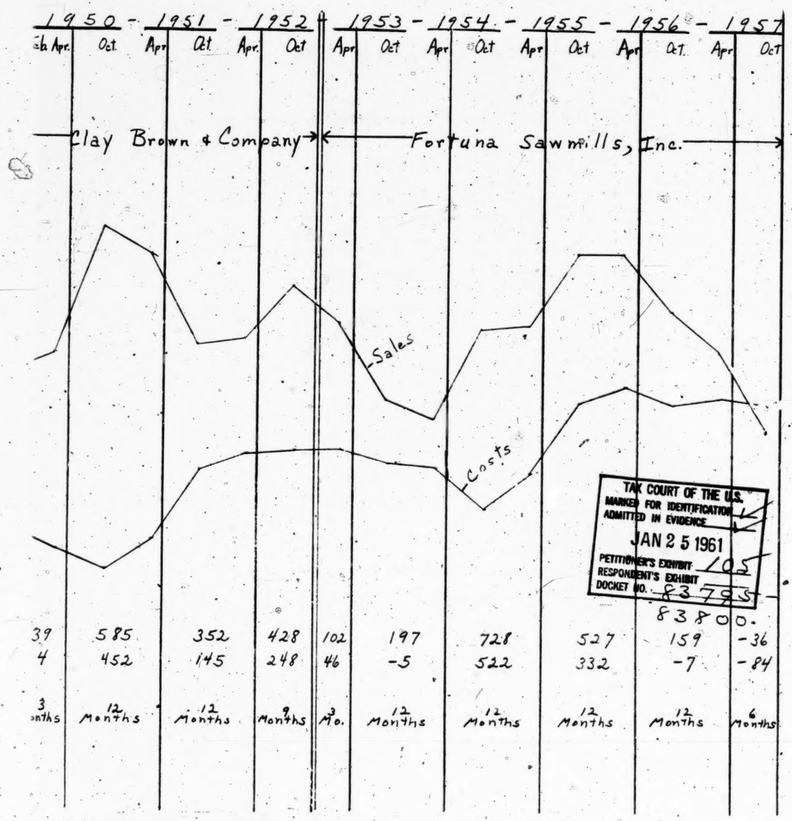
I expect to arrive in Portland late Sunday. I will be at the Benson but will be tied up all day Monday. My present plan is to leave Portland on the non-stop plane to Los Angeles, which I believe leaves there at 2:30 P.M. on Wednesday.

Sincerely,

L. H. SEAGRAVE

LHS:HL





Clay Brown & Company
and
Fortuna Sawmills, Inc.

Graph showing relationship of manufacturing costs to selling prices, and their influence on profits.

— Top = Net sales average (After deducting freight and discounts).

— Bottom = Direct costs per thousand feet board measure to manufacture lumber (Including cost of logs — less depreciation and rent).

1-20-61

338 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 18228-18233

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CLAY B. BROWN, ET AL., *Respondents*.

Statement of Points—Filed October 1, 1962

Pursuant to Rule 17.6 of the Rules of this Court, petitioner hereby states that he intends to rely upon the following points on review of these consolidated cases:

1. The Tax Court erred in holding and deciding that the taxpayers realized long-term capital gains rather than ordinary income on the purported sale of their stock to a tax-exempt corporation.

2. If the Tax Court's holding that the transaction involved was a bona fide sale constitutes a conclusion of law, the Tax Court erred as a matter of law.

3. If the Tax Court's holding that the transaction involved was a bona fide sale constitutes an ultimate finding of fact, such finding was clearly erroneous under established standards of review.

4. The Tax Court erred in entering decisions for the taxpayers.

/s/ LOUIS F. OBERDORFER,
Assistant Attorney General,
Counsel for the Petitioner.

Dated this 28th day of September, 1962.

(File endorsement omitted)

339 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Stipulation—Filed October 8, 1962

It is hereby stipulated by and between the parties hereto that, subject to approval by the Court, the docket entries and all exhibits forming a part of the record on appeal herein shall be presented in their original form rather than being printed, and that the parties in their briefs may refer to the docket entries and exhibits to the same extent and effect as if they had been printed.

Dated:

/s/ LOUIS F. OBERDORFER,
Assistant Attorney General,
Attorney for the Petitioner.

/s/ WILLIAM H. KINSEY,
Attorney for the Respondents.

So Ordered: October 8, 1962.

/s/ RICHARD H. CHAMBERS
Circuit Judge.

340 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Dec. 10, 1963

Nos. 18,228-18,233

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CLAY B. BROWN and DOROTHY E. BROWN, DONALD L. BROWN and INGRID R. BROWN, CHARLES WILLIAM BOOTH and NANCY H. BOOTH, DONALD LEE BROWN, PHILIP F. BROWN, MARILYN BROWN, *Respondents*.

Petition to Review a Decision of the
Tax Court of the United States

Before: HAMLIN and DUNIWAY, Circuit Judges
and
KUNZEL, District Judge

DUNIWAY, Circuit Judge:

The Commissioner of Internal Revenue asks us to reverse decisions of the Tax Court. We are of the opinion that the decisions must be affirmed.

Involved is a transaction of the type described by Moore and Dohan in an article entitled: "Sales, Churches and Monkeyshines," 11 Tax L. Rev. 87 (1956), and by Lanning in an article entitled: "Tax Erosion and the 'Bootstrap sale' of a Business," 108 U. of Pa. L. Rev. 623 (1960). The transaction is described in great detail in the findings of the Tax Court, which are reported at 37 T.C. 461. In his opening brief the Commissioner states: "No exception is taken to the detailed basic findings of the Tax Court."

In the same brief the Commissioner summarizes
341 what he contends are the essentials of the transaction. We quote the summary, but with additions, in brackets, from the record:

> "Taxpayers, consisting of Clay Brown, his wife and three children, and the two Booths, owned substantially all of the stock of Clay Brown & Company, which had lumber interests and saw mills near Fortuna, California. Although the total cost basis of

their investment was only $42,000, the accumulated surplus of the corporation at January 31, 1953 was $448,472, and prospects of future earnings were good.

In the summer of 1952, Clay Brown, the president of the corporation and spokesman for the other stockholders, was approached by a representative of the Institute, a tax-exempt corporation, who supplied him with brochures describing the tax advantages of a particular type of 'sale' transaction. [There was considerable bargaining, at arms length, and a price was agreed upon that was within a reasonable range in light of the earnings history of the corporation and the adjusted net worth of its assets.] When, as it happened, taxpayers agreed to the plan, a complex set of interrelated legal documents was drafted to give it effect. Pursuant to the overall plan agreed upon in advance, the following steps were taken:

(a) Taxpayers endorsed and delivered all of their shares in the corporation to the Institute, together with $125,000 face amount of promissory notes of the corporation held by Clay Brown and his wife. On the same day, February 4, 1953, the Institute delivered to taxpayers its promissory note in the face amount of $1,300,000. The note, which was to mature approximately 10 years later, was nonnegotiable and noninterest bearing. The Institute assumed no liability for payment of the note from its own assets. Payment of the purchase price was to be made solely out of amounts received by the Institute as 'rental' income of the business assets, of which 90 percent would be turned over to taxpayer as periodic installments.

(b) The Institute was [illegible] no option as to the disposition of the property, which was provided for in predrafted instruments. The following steps were
342 taken pursuant to the plan: (1) The corporation was dissolved; (2) $5,000 of the current assets was turned over to taxpayers as a down payment; (3) the remaining net current assets were 'sold' for another promissory note to a new corporation, Fortuna Mills, Inc., organized by taxpayer Clay Brown's attorneys for the specific purpose of taking over the business

of the dissolved corporation; [All of the issued stock of Fortuna was purchased by the attorneys, with their own funds, for $25,000.] (4) all of the other assets were mortgaged back to taxpayers, permitting reacquisition of [that portion of] the business assets in the event of default on the installments on the purchase price; (5) the same assets were 'rented' by the Institute to Fortuna for 80 per cent of the net profits of the business, without allowance for taxes or depreciation. The Institute retaining 10 per cent of this amount, was obligated to turn over the balance to taxpayers to be applied toward the purchase price.

(e) As part of the plan, taxpayer Clay Brown was employed as 'general manager' of Fortuna at an annual salary of $25,000, and it was provided that if he ceased to act as general manager, his successor would be selected by taxpayers. He exercised substantially the same powers as those which he had as president of the dissolved corporation, and no property could be sold without his consent. Moreover, Brown personally guaranteed mortgage loans of the old company transferred to Fortuna, and he also personally guaranteed another $50,000 loan to Fortuna, which had been capitalized at only $25,000.

The new Fortuna corporation took over the operation of the business, which continued for 4½ years on the same premises, with the same operating personnel and under practical control of taxpayers. On June 19, 1957, after suffering business reverses, Fortuna shut down the mill on word from Clay Brown. Taxpayers did not exercise their option to declare a default and formally reacquire their property by foreclosure. Instead, they arranged for the Institute to sell the assets, retaining 10 percent of the proceeds. The assets, which had been appraised prior to the original 'sale'
343 to the Institute at more than $1,000,000 were sold at only $300,000, to outsiders at sometime in July, 1959. Taxpayer received 90 percent of the proceeds. Steps were taken at that time to settle out and cancel all of the tricornered arrangements between Fortuna, the Institute and taxpayers. The net financial result of

the plan was that taxpayers received a total of $936,131.85."

We think we should add to this summary certain additional findings and conclusions of the Tax Court which are:

1. That there was a change of economic benefits in the transaction.

2. That the primary motivation of the Institute was the prospect of ending up with the assets free and clear after the purchase price had been fully paid, which would then permit the Institute to convert the property into money for use in cancer research.

In the court below the Commissioner took two alternative positions: One was that the transaction was a sham. This position is abandoned here. The other, which the Commissioner also takes before us, was that the Tax Court erred in holding that there was a sale within the meaning of section 117(a) of the Internal Revenue Code of 1939 and section 1222(3) of the Internal Revenue Code of 1954 because, so the Commissioner says, certain normal aspects of the sale of a business were missing. These are (1) shift of business risk; (2) shift of benefit of income; (3) shift of operational control; (4) permanent shift of ownership of assets and (5) release of sellers from business indebtedness. The Commissioner relies upon *Burnet* v. *Harmel*, 1932, 287 U.S. 103 as to shift of business risk, upon *Helvering* v. *Clifford*, 1940, 309 U.S. 331 as to shift of benefit of income, and on *Commissioner* v. *Sunnen*, 1948, 333 U.S. 591 as to shift of operational control.

We think that the Commissioner's contentions are well answered in the opinion of the Tax Court, and also in the following cases: *Commissioner* v. *Johnson*, 1 Cir., 1959, 267 F.2d 382; *Union Bank* v. *United States*, Ct.Cl., 1961, 285 F.2d 126.

Here, as in those cases, there was a transfer of title;
there was a shift of business risk in the sense that
344 the operation of the business was in the hands of a
new company owned by third persons, albeit managed under a contract by one of the taxpayers; there was a shift of benefit of income in the sense that Fortuna retained 20% of it and the Institute retained 10% of 80%;

there was no understanding that the assets were to come back to the taxpayers under any circumstances other than a default in the payment of the purchase price; there was a permanent shift of ownership of assets. The management contract and the guarantee of certain of Fortuna's borrowings by one of the taxpayers (Clay Brown), were designed to secure the payment of the price. There was no understanding that, if the business should be unsuccessful, Brown would take action to "trigger" a default, thus causing a reversion of the mortgaged assets to the taxpayers. As was said by the court in *Commissioner* v. *Johnson, supra,* "The mere fact that the security holders may in the future have to resume proprietorship of the enterprise does not nullify the fact that they had sold those proprietary interests." (267 F.2d at 385)

The Commissioner relies also on *Kolkey* v. *Commissioner,* 7 Cir., 1958, 254 F. 2d 51. This case was distinguished in *Commissioner* v. *Johnson, supra,* on the ground that in *Kolkey* the facts were different and the Tax Court had found, in substance in that case, that there was no sale. The Tax Court made the same distinction here, and we think it was correct. We think that the real holding in *Kolkey* was that the transaction was a sham. Here, the finding is the other way and the evidence sustains it.

There is no question that this transaction took the form that it did because the Institute is a tax-exempt corporation and that the price to be paid was probably greater for that reason. These facts may have some relevance in connection with possible tax liabilities of the Institute, but they do not, as a matter of law, establish that, so far as the taxpayers were concerned, the sale of their stock was not a genuine sale, which is the only issue involved in this case.

We think that it is of some significance that the problem of misuse by tax-exempt organizations of their tax exemption in transactions similar to this was considered by the Congress, which adopted certain remedial legislation
345 in the Revenue Act of 1950. The history of this legislation appears in H.R.Rep. No. 2319, 81st Cong. 2d Sess., 1950-2, Cum. Bull. 330, 408-11, and in S. Rep. No. 2375, 81st Cong. 2d Sess., 1950-2, Cum. Bull. 483, 502 ff. Certain aspects of the transaction now before us were un-

doubtedly "tailored" to fit the law as amended by Congress in 1950 particularly section 101 of the Revenue Act of 1939 as amended, and sections 421, 422, and 423. These sections all relate to the income and tax exempt status of the purchasing Institute; none of them purports to deny to the sellers the right to treat the sale, for tax purposes, as a sale, and therefore to treat moneys received as capital gains. Congress could have dealt with that aspect of such transactions but did not do so. If, as is indicated by the writers of the articles cited at the beginning of this opinion, the present situation, insofar as the tax position of the sellers is concerned, is undesirable from a tax standpoint, it is still possible for Congress to provide a remedy.

Affirmed.

(File endorsement omitted)

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346 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18228

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CLAY B. BROWN, et al., *Respondent*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

347 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18229

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

DONALD L. BROWN and INGRID R. BROWN, *Respondents*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

348 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18230

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CHARLES WILLIAM BOOTH and NANCY H. BOOTH, *Respondents*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

349 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18231

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,
v.
DONALD LEE BROWN, *Respondent*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

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350 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18232

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,
v.
PHILLIP F. BROWN, *Respondent*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

351 IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18233

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

MARILYN BROWN, *Respondent*.

Judgment—December 10, 1963

Upon Petition to Review a Decision of The Tax Court of the United States, ...

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, ... and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered December 10, 1963

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352 (Clerk's Certificate to foregoing transcript omitted in printing)

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353 SUPREME COURT OF THE UNITED STATES

No. ....., October Term, 1963

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CLAY B. BROWN, et al.

Order Extending Time to File Petition for Writ of Certiorari
April 3, 1964

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, further extended to and including April 24, 1964.

WM. O. DOUGLAS
Associate Justice of the Supreme Court of the United States.

Dated this 3rd day of April, 1964

No. 1041, October Term, 1963

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

CLAY B. BROWN, et al.

Order Allowing Certiorari—June 8, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.